

Executive Committee Meeting

May 5 & 6, 1994

Multistate Tax Commission



**RESOLUTION OF THE EXECUTIVE COMMITTEE
OF THE MULTISTATE TAX COMMISSION
PURSUANT TO BYLAW 7 REGARDING PUBLIC LAW 86-272**

WHEREAS, the Hearing Officer, Alan H. Friedman, after public hearing duly held pursuant to Article VII(2) of the Multistate Tax Compact and Bylaw 7(a) of the Commission, has submitted his "Final Report of Hearing Officer Regarding Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272" dated March 21, 1994; and

WHEREAS, the Hearing Officer has recommended, among other things, the adoption by the interested states of the Multistate Tax Commission and any other state wishing to do so, of the provisions contained in Attachment 7 to said Final Report; and

WHEREAS, Bylaw 7(g) requires such a recommendation be circulated to the affected members of the Multistate Tax Commission to determine if they will consider the recommendation for adoption within their respective jurisdictions.

NOW, THEREFORE, IT IS RESOLVED THAT the Executive Director is directed to survey the affected Commission member states pursuant to said Bylaw 7(g) and to report the results thereof to the Chairman of the Executive Committee as soon as practicable, but no later than July 15, 1994; and

IT IS FURTHER RESOLVED THAT the recommendation so surveyed shall be either that attached as Exhibit 7 to the Final Report of Hearing Officer or one containing any technical changes that may be made thereon.

Entered this ____ day of May, 1994 by the Executive Committee of the Multistate Tax Commission.

Attest:

Dan R. Bucks
Executive Director

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Multistate Tax Commission



March 21, 1994

Mr. Timothy J. Leathers
Commissioner of Revenue
Arkansas Department of Revenue
P.O. Box 1272
Little Rock, AR 72203

Re: *Final Report of Hearing Officer Regarding
Public Law 86-272 Statement*

Dear Commissioner Leathers:

Pursuant to Article VII of the Multistate Tax Compact and Multistate Tax Commission Bylaw 7, I am enclosing a copy of my "Final Report of Hearing Officer Regarding Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272" for your review. The Final Report addresses eleven major issues and the recommended Statement contains several other changes that are suggested to be made to the version of the Statement approved by the Executive Committee on January 22, 1993. The eleven issues specifically discussed are the following:

- Issue 1:** Whether an "in-home" office is protected under the Public Law?
- Issue 2:** Whether the in-state possession and use of certain business equipment should be protected activity?
- Issue 3:** Whether the in-state delivery of goods in the seller's own trucks removes the protection under the Public Law?
- Issue 4:** Whether the providing of shipment or delivery information or the coordination of deliveries into the state should be protected activity?

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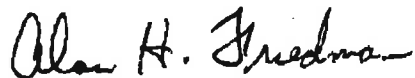
- Issue 5:** Whether a state should adopt a *de minimis* level of gross receipts, property, payroll or other factors after applying the Public Law to determine whether to assert taxing jurisdiction?
- Issue 6:** Whether the Statement should extend the protections under the Public Law to sellers of services and to those who perform services in connection with the sale of goods?
- Issue 7:** Whether collection of a seller's accounts that are conducted through third parties removes the protection under the Public Law?
- Issue 8:** Whether the law of the state of destination should apply for the purpose of settling conflicts regarding the operation of jurisdictional and throwback rules?
- Issue 9:** Whether registration or qualification to do business in the state, by itself, should be a protected activity?
- Issue 10:** Whether the conducting of activities that are unprotected under the Public Law during a part of the tax year removes the protection from sales generated and income earned prior to the conducting of the unprotected activities?
- Issue 11:** Whether the states should apply the *Joyce Rule* or the *Finnigan/Airborne Navigation* approach for determining the extent of protection under the Public Law?

Since the Final Report is considerably lengthy, given all of the attachments, I have attached a Summary of Issues and Recommendations for your convenience. The Summary sets forth extracts from the Report of the specific issues discussed, along with the Hearing Officer recommendations that I have made. However, as I noted before, several other changes have been recommended that were not of a type that discussion was required. Those additional suggested changes can best be gleaned from Attachment 8 to the Final Report. That Attachment is the mark-up version reflecting the suggested additions and deletions to be made to the Statement approved by the Executive Committee on January 22, 1993.

Mr. Timothy J. Leathers
March 21, 1994
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A copy of this Final Report will be provided to all Commission member Tax Administrators over the next several days. Should you have any questions or wish to discuss this or any other matter before the Executive Committee meeting on May 5th, please do not hesitate to contact me.

Sincerely yours,

A handwritten signature in cursive script that reads "Alan H. Friedman".

Alan H. Friedman
Hearing Officer

cc: **Members of the Executive Committee**
Tax Administrators, Member and Non-member States

SUMMARY OF ISSUES AND RECOMMENDATIONS

Issue 1: *Whether an "in-home" office is
protected under the Public Law?*

Recommendation:

The following language is recommended to be included in the Statement at paragraph IV.A.18 under 'Unprotected Activities':

18. Maintaining, by any employee or other representative, an office or place of business of any kind (other than an in-home office located within the residence of the employee or representative that (i) is not publicly attributed to the company or to the employee or representative of the company in an employee or representative capacity, and (ii) so long as the use of such office is limited to soliciting and receiving orders from customers; for transmitting such orders outside the state for acceptance or rejection by the company; or for such other activities that are protected under Public Law 86-272 or under paragraph IV.B. of this Statement.

A telephone listing or other public listing within the state for the company or for an employee or representative of the company in such capacity or other indications through advertising or business literature that the company or its employee or representative can be contacted at a specific address within the state shall normally be determined as the company maintaining within this state an office or place of business attributable to the company or to its employee or representative in a representative capacity . However, the normal distribution and use of business cards and stationery identifying the employee's or representative's name, address, telephone and fax numbers and affiliation with the company shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the company or its employee or representative.

The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described above shall, by itself, cause the loss of protection under this Statement.

For the purpose of this subsection it is not relevant whether the company pays directly, indirectly, or not at all for the cost of maintaining such in-home office.

Issue 2: *Whether the in-state possession and use of certain business equipment should be protected activity?*

Recommendation:

The Hearing Officer recommends the addition of paragraph IV.B.13. under "Protected Activities" to provide:

- 13. Owning, leasing, using or maintaining personal property for use in the employee or representative's "in-home" office or automobile that is solely limited to the conducting of protected activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer and computer software that is limited to the carrying on of protected solicitation and activity entirely ancillary to such solicitation or permitted by this Statement under paragraph IV.B. shall not, by itself, remove the protection under this Statement.**

Issue 3: *Whether the in-state delivery of goods in the seller's own trucks removes the protection under the Public Law?*

Recommendation:

For the reasons set forth in the Final Report of Hearing Officer, it is recommended that the following provision be set forth as an "Unprotected Activity" by adding to paragraph IV.A.:

- 20. Shipping or delivering goods into this state by means of private vehicle, rail, water, air or other carrier, irrespective of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser.**

Issue 4: *Whether the providing of shipment or delivery information or the coordination of deliveries into the state should be a protected activity?*

Recommendation:

It is recommended that original paragraph II.A.13. appearing in the Phase One Statement be deleted and the following be treated as a "Protected Activity" by adding the following provision to IV.B.:

- 8. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order.**

Issue 5: *Whether a state should adopt a de minimis level of gross receipts, property, payroll or other factors after applying the Public Law to determine whether to assert taxing jurisdiction?*

Recommendation:

The Hearing Officer recommends further consideration by the Executive and Uniformity Committees of the propriety of adopting *de minimis* provisions such as the following:

De Minimis Level of Gross Receipts, Federal Taxable Income and In-State Apportionment Factor.

Any corporation subject to the personal jurisdiction of this State that is not otherwise protected under Public Law 86-272 or Section IV.B. from being required to pay a corporate income (franchise) tax to this State shall not be required to file a corporate income (franchise) tax return or pay such a tax for any taxable year unless, during such taxable year, the corporation either--

(1) had gross receipts from interstate transactions-

(A) within the United states exceeding \$_____, or

(B) within the State exceeding \$_____; or

(2) had a federal taxable income prior to state adjustments exceeding \$_____ and an apportionment factor attributable to this State exceeding ____%.

Issue 6: *Whether the Statement should extend the protections under the Public Law to sellers of services and to those who perform services in connection with the sale of goods?*

Recommendation:

In order to provide clear notice to the business community of the issue regarding the delivery of services, either connected or not with the solicitation and delivery of tangible personal property, the Hearing Officer suggests the following language be added to Section I of the Statement:

The sale or delivery and the solicitation for the sale or delivery of any type of service that is not either (i) ancillary to solicitation or (ii) otherwise set forth as a protected activity under the Section IV.B. hereof is not protected under Public Law 86-272 or this Statement.

Issue 7: *Whether collection of a seller's accounts that are conducted through third parties removes the protection under the Public Law?*

Recommendation:

Paragraph IV.A.2. under "Protected Activities" should be changed to provide as follows:

Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.

Issue 8: *Whether the law of the state of destination should apply for the purpose of settling conflicts regarding the operation of jurisdictional and throwback rules?*

Recommendation:

The Hearing Officer recommends that, in order to ensure that the receipts factor effectively maintains its reflection of the contribution of the market in the apportionment formula, that the following Article VI. be added to the Statement.

**VI.
APPLICATION OF DESTINATION STATE LAW
IN CASE OF CONFLICT**

When it appears that two or more signatory states have included or will include the same receipts from a sale in their respective sales factor numerators, at the written request of the company, said states will in good faith confer with one another to determine which state should be assigned said receipts. Such conference shall identify what law, regulation or written guideline, if any, has been adopted in the state of destination with respect to the issue. The state of destination shall be that location at which the purchaser or its designee actually receives the property, regardless of f.o.b. point or other conditions of sale.

In determining which state is to receive the assignment of the receipts at issue, preference shall be given to any clearly applicable law, regulation or written guideline that has been adopted in state of destination. However, except in the case of the definition of what constitutes "tangible personal property", this state is not required by this Statement to follow any other state's law, regulation or written guideline should this state determine that to do so (i) would conflict with its own laws, regulations, or written guidelines and (ii) would not clearly reflect the income-producing activity of the company within this state.

Notwithstanding any provision set forth in this Statement to the contrary, as between this state and any other signatory state, this state agrees to apply the definition of "tangible personal property" that exists in the state of destination to determine the application of P.L. 86-272 and issues of throwback, if any. Should the state of destination

not have any applicable definition of such term so that it could be reasonably determined whether the property at issue constitutes "tangible personal property", then each signatory state may treat such property in any manner that would clearly reflect the income-producing activity of the company within said state .

Issue 9: *Whether registration or qualification to do business in the state, by itself, should be a protected activity?*

Recommendation:

In the interest of achieving as much uniformity as possible without protracted litigation having to settle the issue in each state, the Hearing Officer recommends that a state treat the mere registration to do business therein by an out-of-state company as not removing the immunity otherwise available under the Public Law. To this end, the Hearing Officer recommends that paragraph VII.C. be added to the Statement to provide:

C. REGISTRATION OR QUALIFICATION TO DO BUSINESS

A company that registers or otherwise formally qualifies to do business within this state does not, by that fact alone, lose its protection under P.L. 86-272. Where, separate from or ancillary to such registration or qualification, the company receives and seeks to use or protect any additional benefit or protection from this state through activity not otherwise protected under P.L. 86-272 or this Statement, the protection shall be removed.

Issue 10: *Does the conducting of activities that are unprotected under the Public Law during a part of the tax year remove the protection from sales generated and income earned prior to the conducting of the unprotected activities?*

Recommendation:

The Hearing Officer recommends that the following language be added as paragraph VII.D. of the Statement to clarify that no protection attaches to any extent during any tax year in which any unprotected activity was conducted:

D. PART OF TAX YEAR TO WHICH PROTECTION ATTACHES.

The protection afforded under P.L. 86-272 and the provisions of this Statement shall be determined on a tax year by tax year basis. Therefore, if at any time during a tax year the company conducts activities that are not protected under P.L. 86-272 or this Statement, no sales in this state or income earned by the company attributed to this state during any part of said tax year shall be protected under said Public Law or this Statement.

Issue 11: *Whether the states should apply the Joyce Rule or the Finnigan/ Airborne Navigation approach for determining the extent of protection under the Public Law?*

Recommendation:

The Hearing Officer recommends that the following provision be provided as paragraph VII.E. to clarify that the signatory state has elected to follow the attribution principle set forth in *Appeal of Joyce, Inc.*, Cal. St. Bd. of Equal. (11/23/66) until further notice:

E. APPLICATION OF THE JOYCE RULE.

In determining whether the activities of any company have been conducted within this state beyond the protection of P.L. 86-272 or paragraph IV.B. of this Statement, the principle established in *Appeal of Joyce, Inc.*, Cal. St. Bd. of Equal. (11/23/66), commonly known as the "Joyce Rule", shall apply. Therefore, only those in-state activities that are conducted by or on behalf of said company shall be considered for this purpose. Activities that are conducted by any other person or business entity, whether or not said person or business entity is affiliated with said company, shall not be considered attributable to said company, unless such other person or business entity was acting in a representative capacity on behalf of said company.

ATTACHMENT 7

**STATEMENT OF INFORMATION CONCERNING PRACTICES OF
MULTISTATE TAX COMMISSION AND SIGNATORY STATES UNDER PUBLIC LAW
86-272**

(Phase Two Statement Recommended for Adoption by the States)

**STATEMENT OF INFORMATION CONCERNING PRACTICES OF
MULTISTATE TAX COMMISSION AND SIGNATORY STATES UNDER
PUBLIC LAW 86-272**

(Recommended Phase Two Statement)

Public Law 86-272, 15 U.S.C. 381-384, (hereafter P.L. 86-272) restricts a state from imposing a net income tax on income derived within its borders from interstate commerce if the only business activity of the company within the state consists of the solicitation of orders for sales of tangible personal property, which orders are to be sent outside the state for acceptance or rejection, and, if accepted, are filled by shipment or delivery from a point outside the state. The term "net income tax" includes a franchise tax measured by net income. If any sales are made into a state which is precluded by P.L. 86-272 from taxing the income of the seller, such sales remain subject to throwback to the appropriate state which does have jurisdiction to impose its net income tax upon the income derived from those sales.

It is the policy of the state signatories hereto to impose their net income tax, subject to State and Federal legislative limitations, to the fullest extent constitutionally permissible. Interpretation of the solicitation of orders standard in P.L. 86-272 requires a determination of the fair meaning of that term in the first instance. The United States Supreme Court has recently established a standard for interpreting the term "solicitation" and this Statement has been revised to conform to such standard. *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, ___ U.S. ___, 112 S.Ct. 2447 (1992). In those cases where there may be reasonable differences of opinion as to whether the disputed activity exceeds what is protected by P.L. 86-272, the signatory States will apply the principle that the preemption of state taxation that is required by P.L. 86-272 will be limited to those activities that fall within the "clear and manifest purpose of Congress". . See *Department of Revenue of Oregon v. ACF Industries, Inc., et al.*, ___ U.S. ___, (slip op., pp. 11-12)) (1994), *Cipollone v. Liggett Group, Inc.*, 505 U.S. ___, 112 S.Ct. 2608, 120 L. Ed.2d 407, 422 (1992); *Heublein, Inc. v. South Carolina Tax Com.*, 409 U.S. 275, 281-282 (1972).

The following information reflects the signatory states' current practices with regard to: (1) whether a particular factual circumstance is considered under P.L. 86-272 or permitted under this Statement as either protected or not protected from taxation by reason of P.L. 86-272; and (2) the jurisdictional standards which will apply to sales made in another state for purposes of applying a throwback rule (if applicable) with respect to such sales. It is the intent of the signatory states to apply this Statement uniformly to factual circumstances, irrespective of whether such application involves an analysis for jurisdictional purposes in the state into which such tangible personal property has been shipped or delivered or for throwback purposes in the state from which such property has been shipped or delivered.

I

NATURE OF PROPERTY BEING SOLD

Only the solicitation to sell personal property is afforded immunity under P.L. 86-272; therefore, the leasing, renting, licensing or other disposition of tangible personal property, or transactions involving intangibles, such as franchises, patents, copyrights, trade marks, service marks and the like, or any other type of property are not protected activities under P.L. 86-272.

The sale or delivery and the solicitation for the sale or delivery of any type of service that is not either (1) ancillary to solicitation or (2) otherwise set forth as a protected activity under the Section IV.B. hereof is also not protected under Public Law 86-272 or this Statement.

II

SOLICITATION OF ORDERS AND ACTIVITIES ANCILLARY TO SOLICITATION

For the in-state activity to be a protected activity under P.L. 86-272, it must be limited solely to *solicitation* (except for *de minimis* activities described in Article III. and those activities conducted by independent contractors described in Article V. below). Solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order.

Ancillary activities are those activities that serve no independent business function for the seller apart from their connection to the solicitation of orders. Activities that a seller would engage in apart from soliciting orders shall not be considered as ancillary to the solicitation of orders. The mere assignment of activities to sales personnel does not, merely by such assignment, make such activities ancillary to solicitation of orders. Additionally, activities that seek to promote *sales* are not ancillary, because P.L. 86-272 does not protect activity that facilitates sales; it only protects ancillary activities that facilitate the request for an order. The conducting of activities not falling within the foregoing definition of solicitation will cause the company to lose its protection from a net income tax afforded by P.L. 86-272, unless the disqualifying activities, taken together, are either *de minimis* or are otherwise permitted under this Statement.

III DE MINIMIS ACTIVITIES

De minimis activities are those that, when taken together, establish only a trivial connection with the taxing State. An activity conducted within a taxing State on a regular or systematic basis or pursuant to a company policy (whether such policy is in writing or not) shall normally not be considered trivial. Whether or not an activity consists of a trivial or non-trivial connection with the State is to be measured on both a qualitative and quantitative basis. If such activity either qualitatively or quantitatively creates a non-trivial connection with the taxing State, then such activity exceeds the protection of P.L. 86-272. Establishing that the disqualifying activities only account for a relatively small part of the business conducted within the taxing State is not determinative of whether a *de minimis* level of activity exists. The relative economic importance of the disqualifying in-state activities, as compared to the protected activities, does not determine whether the conduct of the disqualifying activities within the taxing State is inconsistent with the limited protection afforded by P.L. 86-272.

IV

SPECIFIC LISTING OF UNPROTECTED AND PROTECTED ACTIVITIES

The following two listings - IV.A. and IV.B. - set forth the in-state activities that are presently treated by the signatory state as "Unprotected Activities" or "Protected Activities". Such listings may be subject to an amendment by addition or deletion that appears on the individual signatory state's Signature Page attached to this Statement.

The signatory state has included on the list of "Protected Activities" those in-state activities that are either required protection under P.L. 86-272; or, if not so required, that the signatory state, in its discretion, has permitted protection. The mere inclusion of an activity on the listing of "Protected Activities", therefore, is not a statement or admission by the signatory state that said activity is required any protection under the Public Law.

A. UNPROTECTED ACTIVITIES:

The following in-state activities (assuming they are not of a *de minimis* level) are not considered as either solicitation of orders or ancillary thereto or otherwise protected under P.L. 86-272 and will cause otherwise protected sales to lose their protection under the Public Law:

1. Making repairs or providing maintenance or service to the property sold or to be sold.
2. Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.
3. Investigating credit worthiness.
4. Installation or supervision of installation at or after shipment or delivery.
5. Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation.
6. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders.

7. Investigating, handling, or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints when the sole purpose of such mediation is to ingratiate the sales personnel with the customer.
8. Approving or accepting orders.
9. Repossessing property.
10. Securing deposits on sales.
11. Picking up or replacing damaged or returned property.
12. Hiring, training, or supervising personnel, other than personnel involved only in solicitation.
13. Using agency stock checks or any other instrument or process by which sales are made within this state by sales personnel.
14. Maintaining a sample or display room in excess of two weeks (14 days) at any one location within the state during the tax year.
15. Carrying samples for sale, exchange or distribution in any manner for consideration or other value.
16. Owning, leasing, using or maintaining any of the following facilities or property in-state:
 - a. Repair shop.
 - b. Parts department.
 - c. Any kind of office other than an in-home office as described as permitted under IV.A.18 and IV.B.2.
 - d. Warehouse.
 - e. Meeting place for directors, officers, or employees.

- f. Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.
 - g. Telephone answering service that is publicly attributed to the company or to employees or agent(s) of the company in their representative status.
 - h. Mobile stores, i.e., vehicles with drivers who are sales personnel making sales from the vehicles.
 - i. Real property or fixtures to real property of any kind.
17. Consigning stock of goods or other tangible personal property to any person, including an independent contractor, for sale.
 18. Maintaining, by any employee or other representative, an office or place of business of any kind (other than an in-home office located within the residence of the employee or representative that (i) is not publicly attributed to the company or to the employee or representative of the company in an employee or representative capacity , and (ii) so long as the use of such office is limited to soliciting and receiving orders from customers; for transmitting such orders outside the state for acceptance or rejection by the company; or for such other activities that are protected under Public Law 86-272 or under paragraph IV.B. of this Statement.

A telephone listing or other public listing within the state for the company or for an employee or representative of the company in such capacity or other indications through advertising or business literature that the company or its employee or representative can be contacted at a specific address within the state shall normally be determined as the company maintaining within this state an office or place of business attributable to the company or to its employee or representative in a representative capacity . However, the normal distribution and use of business cards and stationery identifying the employee's or representative's name, address, telephone and fax numbers and affiliation with the company shall not, by itself, be considered as

advertising or otherwise publicly attributing an office to the company or its employee or representative.

The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described above shall, by itself, cause the loss of protection under this Statement.

For the purpose of this subsection it is not relevant whether the company pays directly, indirectly, or not at all for the cost of maintaining such in-home office.

19. Entering into franchising or licensing agreements; selling or otherwise disposing of franchises and licenses; or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchisor or licensor to its franchisee or licensee within the state.
20. Shipping or delivering goods into this state by means of private vehicle, rail, water, air or other carrier, irrespective of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser.
21. Conducting any activity not listed in paragraph IV.B. below which is not entirely ancillary to requests for orders, even if such activity helps to increase purchases.

B. PROTECTED ACTIVITIES:

The following in-state activities will not cause the loss of protection for otherwise protected sales:

1. Soliciting orders for sales by any type of advertising.
2. Soliciting of orders by an in-state resident employee or representative of the company, so long as such person does not maintain or use any office or other place of business in the state other than an "in-home" office as described in IV.A.18. above.
3. Carrying samples and promotional materials only for display or distribution without charge or other consideration.

4. Furnishing and setting up display racks and advising customers on the display of the company's products without charge or other consideration.
5. Providing automobiles to sales personnel for their use in conducting protected activities.
6. Passing orders, inquiries and complaints on to the home office.
7. Missionary sales activities; i.e., the solicitation of indirect customers for the company's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers would be protected if such solicitation activities are otherwise immune.
8. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order.
9. Checking of customers' inventories without a charge therefor (for re-order, but not for other purposes such as quality control).
10. Maintaining a sample or display room for two weeks (14 days) or less at any one location within the state during the tax year.
11. Recruiting, training or evaluating sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel.
12. Mediating direct customer complaints when the purpose thereof is solely for ingratiating the sales personnel with the customer and facilitating requests for orders.
13. Owning, leasing, using or maintaining personal property for use in the employee or representative's "in-home" office or automobile that is solely limited to the conducting of protected activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer and computer software that

is limited to the carrying on of protected solicitation and activity entirely ancillary to such solicitation or permitted by this Statement under paragraph IV.B. shall not, by itself, remove the protection under this Statement.

V INDEPENDENT CONTRACTORS

P.L. 86-272 provides protection to certain in-state activities if conducted by an independent contractor that would not be afforded if performed by the company or its employees or other representatives. Independent contractors may engage in the following limited activities in the state without the company's loss of immunity:

1. Soliciting sales.
2. Making sales.
3. Maintaining an office.

Sales representatives who represent a single principal are not considered to be independent contractors and are subject to the same limitations as those provided under P.L. 86-272 and this Statement .

Maintenance of a stock of goods in the state by the independent contractor under consignment or any other type of arrangement with the company, except for purposes of display and solicitation, shall remove the protection.

VI APPLICATION OF DESTINATION STATE LAW IN CASE OF CONFLICT

When it appears that two or more signatory states have included or will include the same receipts from a sale in their respective sales factor numerators, at the written request of the company, said states will in good faith confer with one another to determine which state should be assigned said receipts. Such conference shall identify what law, regulation or written

guideline, if any, has been adopted in the state of destination with respect to the issue. The state of destination shall be that location at which the purchaser or its designee actually receives the property, regardless of f.o.b. point or other conditions of sale.

In determining which state is to receive the assignment of the receipts at issue, preference shall be given to any clearly applicable law, regulation or written guideline that has been adopted in state of destination. However, except in the case of the definition of what constitutes "tangible personal property", this state is not required by this Statement to follow any other state's law, regulation or written guideline should this state determine that to do so (i) would conflict with its own laws, regulations, or written guidelines and (ii) would not clearly reflect the income-producing activity of the company within this state.

Notwithstanding any provision set forth in this Statement to the contrary, as between this state and any other signatory state, this state agrees to apply the definition of "tangible personal property" that exists in the state of destination to determine the application of P.L. 86-272 and issues of throwback, if any. Should the state of destination not have any applicable definition of such term so that it could be reasonably determined whether the property at issue constitutes "tangible personal property", then each signatory state may treat such property in any manner that would clearly reflect the income-producing activity of the company within said state.

VII MISCELLANEOUS PRACTICES

A. APPLICATION OF STATEMENT TO FOREIGN COMMERCE.

Public Law 86-272 specifically applies, by its terms, to "interstate commerce" and does not directly apply to foreign commerce. The states are free, however, to apply the same standards set forth in the Public Law and in this Statement to business activities in foreign commerce to ensure that foreign and interstate commerce are treated on the same basis. Such an application also avoids the necessity of expensive and difficult efforts in the identification and application of the varied jurisdictional laws and rules existing in foreign countries.

This state will apply the provisions of Public Law 86-272 and of this Statement to business activities conducted in foreign commerce. Therefore, whether business activities are conducted by (i) a foreign or domestic company selling tangible personal property into a country outside of the United States from a point within this state or by (ii) either company selling such property into this state from a point outside of the United States, the principles under this Statement apply equally to determine whether the sales transactions are protected and the company immune from taxation in either this state or in the foreign country, as the case might be, and whether, if applicable, this state will apply its throwback provisions.

**B. APPLICATION TO CORPORATION INCORPORATED IN STATE
OR TO PERSON RESIDENT OR DOMICILED IN STATE.**

The protection afforded by P.L. 86-272 and the provisions of this Statement do not apply to any corporation incorporated within this state or to any person who is a resident of or domiciled in this state.

C. REGISTRATION OR QUALIFICATION TO DO BUSINESS.

A company that registers or otherwise formally qualifies to do business within this state does not, by that fact alone, lose its protection under P.L. 86-272. Where, separate from or ancillary to such registration or qualification, the company receives and seeks to use or protect any additional benefit or protection from this state through activity not otherwise protected under P.L. 86-272 or this Statement, such protection shall be removed.

**D. LOSS OF PROTECTION FOR CONDUCTING UNPROTECTED
ACTIVITY DURING PART OF TAX YEAR.**

The protection afforded under P.L. 86-272 and the provisions of this Statement shall be determined on a tax year by tax year basis. Therefore, if at any time during a tax year the company conduct activities that are not protected under P.L. 86-272 or this Statement, no sales in this state or income earned by the company attributed to this state during any part of said tax year shall be protected from taxation under said Public Law or this Statement.

E. APPLICATION OF THE JOYCE RULE.

In determining whether the activities of any company have been conducted within this state beyond the protection of P.L. 86-272 or paragraph IV.B. of this Statement, the principle established in *Appeal of Joyce, Inc.*, Cal. St. Bd. of Equal. (11/23/66), commonly known as the "Joyce Rule", shall apply. Therefore, only those in-state activities that are conducted by or on behalf of said company shall be considered for this purpose. Activities that are conducted by any other person or business entity, whether or not said person or business entity is affiliated with said company, shall not be considered attributable to said company, unless such other person or business entity was acting in a representative capacity on behalf of said company.

STATE SIGNATURE PAGE

Except as may be set forth below, the foregoing "Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272" accurately describes the practices presently followed by the State of _____ in applying said Public Law and incorporates the qualifications set forth in the Resolution of the Executive Committee of the Commission dated _____, 1994 and attached hereto.

DELETIONS:

ADDITIONS:

Executed by: _____

Effective date: _____

Multistate Tax Commission



**FINAL REPORT OF HEARING OFFICER REGARDING STATEMENT OF
INFORMATION CONCERNING PRACTICES OF MULTISTATE TAX
COMMISSION AND SIGNATORY STATES UNDER PUBLIC LAW 86-272**

Submitted by Alan H. Friedman, Hearing Officer

March 21, 1994

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**FINAL REPORT OF HEARING OFFICER REGARDING STATEMENT OF
INFORMATION CONCERNING PRACTICES OF MULTISTATE TAX
COMMISSION AND SIGNATORY STATES UNDER PUBLIC LAW 86-272**

The following Final Report is submitted pursuant to Article VII of the Multistate Tax Compact and Bylaw No. 7 of the Multistate Tax Commission. Those provisions require the Hearing Officer to submit to the Commission's Executive Committee a report which contains a synopsis of the hearing proceedings and a detailed recommendation for Commission action. In the case of a public hearing held pursuant to Article VII of the Compact, the final recommendation of the Hearing Officer is to include a draft of the proposed regulation or other uniformity recommendation which is the subject matter of the hearing.

This Final Report of the Hearing Officer is divided into four sections - an introductory part (Section I); the Hearing Officer's recommendations for Commission action concerning the adoption of the proposed "Statement of Information Concerning Multistate Tax Commission and Signatory States under Public Law 86-272" (hereafter referred to as either "Statement" or "Phase Two Statement") (Section II); a discussion of the major substantive issues addressed in this Final Report (Section III); and a brief conclusion (Section IV).

I.

**INTRODUCTION AND BACKGROUND TO PROPOSED STATEMENT OF
INFORMATION CONCERNING PRACTICES OF MULTISTATE TAX COMMISSION
AND SIGNATORY STATES UNDER PUBLIC LAW 86-272.**

In 1959, Congress enacted Public Law 86-272 (15 U.S.C. §§381-384) which prohibited market states and their political subdivisions from imposing a net income tax on out-of-state businesses whose in-state activities were limited. P.L. 86-272 provides, in part, as follows:

"(a) No State shall have power to impose a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

- (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) The provisions of subsection (a) shall not apply to the imposition of a net income tax by any State or political subdivision thereof, with respect to --

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) For the purposes of subsection (a), a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

(d) For purposes of this section --

(1) the term 'independent contractor' means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of tangible -personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term 'representative' does not include an independent contractor."

For several years after its passage, various state courts were called upon to interpret this federal law, in particular the meaning of the phrase "solicitation of orders". The state court interpretations ranged from those of a narrow interpretation of the phrase to those of a more broad construction. Compare, for example, *Clairol, Inc. v. Kingsley*, 109 N.J. Super. 22, 262 A.2d 213, aff'd, 57 N.J. 199, 270 A.2d 702 (1970), appeal dismissed, 402 U.S. 902 (1971) and *Hervey v. AMF Beaird, Inc.*, 250 Ark. 147, 464 S.W.2d 557 (1971)

with *United States Tobacco Co. v. Commonwealth*, 478 Pa. 125, 386 A.2d 471, cert. denied, 439 U.S. 880 (1978) and *Gillette Co. v. State Tax Comm'n.*, 56 App. Div. 2d 475, 393 N.Y.S.2d 186 (1977), aff'd 45 N.Y.2d 846, 410 N.Y.S.2d 65, 382 N.E.2d 764 (N.Y. 1978).¹

In 1986, the Multistate Tax Commission's member states adopted the original Guideline, formally entitled "Information Concerning Practices of Multistate Tax Commission States under Public Law 86-272" (hereafter "Guideline" and set forth in Attachment 1). This Guideline was intended to increase uniformity in the states' approaches to the construction of Public Law 86-272 and to provide notice to taxpayers and their representatives of what practices were then being followed by each of the signatory states in their respective interpretations of the Public Law.² The principal sections of the Guideline set forth a listing of what activities were being treated by the signatory states as either (1) falling within the Public Law's definition of "solicitation" or other protected activity; or (2) even though falling outside the protection of the Public Law, the states were willing to allow as protected from net income taxation. The Guideline also specified certain activities that the signatory states were interpreting as falling outside of the meaning of the term "solicitation" and which, thereby, removed, in the signatory states' view, the protection of the Public Law from such activities and the taxpayers engaged in them.

A. Phase One Modifications to the Guideline

By its resolution adopting the Guideline, the Executive Committee of the Multistate Tax Commission suggested that the Guideline be revisited within several years to determine whether it should be amended in any part. In 1992, the United States Supreme Court decided the case of *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, ___ U.S. ___, 112 S.Ct. 2447 (1992). While this decision provided additional guidance as to the meaning of the phrase "solicitation of orders" contained in the Public Law, it answered few other

¹ For a discussion of the pre-*Wrigley* cases construing Public Law 86-272, see Tatarowicz, "State Judicial and Administrative Interpretations of U.S. Public Law 86-272", Vol. 38 Tax Lawyer 292 (1985).

² It is important to note that on occasion a state might become signatory to the Guideline (and later to the Statement) by agreeing to most, but not all of its provisions. In such cases, the state would, in writing, reserve or amend for its own state's purposes one or more of the Statement's provisions. These changes are addressed in addenda incorporated on the State Tax Administrators' Signature Pages.

questions and raised several more. The *Wrigley* case prompted the Executive Committee to conduct the previously anticipated review of the Guideline.

The Executive Committee approved the review of the original Guideline in two distinct phases. Phase One has already been completed and involved the development by the Commission's Uniformity Committee of recommended changes to the Guideline that were clearly necessitated by the *Wrigley* decision. On January 22, 1993, those changes were adopted by Executive Committee Resolution. By separate Resolution, the Executive Committee also required a public hearing be held on the changes just adopted, as well as any other suggested changes. (See Attachment 2 which consists of the two Executive Committee Resolutions of January 22, 1993 and the revised "Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272" (hereafter "Phase One Statement")). As of the date of this Final Report, twenty-three states had become signatories to or otherwise adopted all or substantially all of the Phase One Statement and several other states had otherwise indicated intentions to adopt or follow significant portions thereof.³

B. Phase Two Public Hearing Process

Phase Two of the process to revise the original Guideline consisted of the public hearing ordered by the Executive Committee at which all interested persons were provided an opportunity to present written and oral testimony about any aspect of the Phase One Statement. The public sessions of this hearing were held on May 28, 1993 in Los Angeles, California, June 29, 1993 in Salt Lake City, Utah, and October 1, 1993 in Washington, D.C. (See the Notice of Hearing appended as Attachment 3).

³ Alabama, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Hawaii, Idaho, Illinois, Kansas, Louisiana, Maine, Missouri, Montana, New Jersey, New Mexico, North Dakota, Oregon, South Dakota, Tennessee, Texas and Utah. It should be noted that the states of California, Connecticut, Kansas and New Jersey adopted a limited exception or addition to the Phase One Statement on behalf of their respective states. New York, Wisconsin and South Carolina have adopted several provisions similar to those contained in the Phase One Statement. See Attachments 10 and 13. It is recommended that all exceptions and additions to the Phase Two Statement be published by the Commission after the Statement is adopted by all states desiring to do so.

Seven questions sought by the Hearing Officer to be addressed during the public hearing process were set forth in the Notice of Hearing as follows:

1. **What changes should be made to the P.L. 86-272 Statement by way of additions and/or deletions to the listings of "Immune Activities" and "Non-Immune Activities"?**
2. **How should the term "office" be defined for purposes of Article II.A.18. and Article II.B.10 of the P.L. 86-272 Statement?**
3. **What "ancillary activities" should be specifically set forth and described in the P.L. 86-272 Statement?**
4. **Should one or more uniform tests be included that describe what level of non-immune activities will constitute a de minimis level of in-state activity? If so, what should such test(s) be?**
5. **Should the delivery of goods into the state by truck or other mode of interstate transportation that is owned, rented or otherwise controlled by the seller remove the immunity under P.L. 86-272?**
6. **How should sales that consist of a mixture of tangible personal property and services be treated for purposes of immunity under P.L. 86-272?**
7. **Such other issues and suggestions that state representatives and other members of the taxpaying community may wish to present for consideration.**

At each of the public sessions of the hearing, interested persons raised additional issues and suggestions and these will be addressed during the course of this Report at Section III. For listings of persons attending each of the public sessions, see Attachments 4, 5 and 6.

II.
RECOMMENDATION OF HEARING OFFICER: STATEMENT OF
INFORMATION CONCERNING PRACTICES OF MULTISTATE TAX COMMISSION
AND SIGNATORY STATES UNDER PUBLIC LAW 86-272.

In the normal course of proceedings that involve uniformity recommendations, the Uniformity Committee would have developed its proposal and the Hearing Officer, after public input, would make a recommendation on that proposal directly to the Executive Committee. Because the Uniformity Committee of the Commission normally initiates, develops and thoroughly reviews uniformity recommendations before referring them to public hearing, there is often no need to refer the matter back to the Uniformity Committee for further review and recommendation. Here, however, the Uniformity Committee had not been directly involved in the development of many of the Phase Two revisions to the Commission's Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272.

Pursuant to direction from the Executive Committee, the Commission's Uniformity Committee was provided an opportunity to review the proposed Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272 (Attachment 7) (hereafter "Phase Two Statement") at its meeting held on March 1, 1994. The Hearing Officer now submits this Final Report recommending that interested Commission member states and any other state wishing to support this uniformity effort adopt Attachment 7. Attachment 8 is a mark-up version of Attachment 7 and reflects the specific changes the Hearing Officer recommends to be made to the Phase One Statement (Attachment 2).⁴

⁴ Recommended changes to the Phase One Statement that are set forth in Attachment 8 are noted by underlining to indicate recommended additions and by strikeout to indicate recommended deletions.

III.

DISCUSSION OF MAJOR ISSUES RAISED DURING PUBLIC HEARING AND RECOMMENDATIONS

A. The Public Hearing Input

At the outset it is important to note the character of the public proceedings with respect to what public input was received and what was not. In general, these proceedings differed substantially from others in which the Hearing Officer has participated. When uniformity proposals have addressed specific industry groups, such as publishers, broadcasters, financial institutions and the like, an identifiable constituency formed to address the proposals. Representatives of specific companies and industries are generally not reluctant to express a myriad of responses to an MTC uniformity proposal. Those responses range from specific opposition, criticism (constructive and otherwise) and, occasionally, positive embrace. All of these reactions are to be expected and the energy and attention inherent in those reactions can be used in positive ways to reach a final recommendation.

In these proceedings, however, with little exception, there were no specific companies or industries that believed themselves the direct beneficiary or target of the pending uniformity proposal. A great majority of interstate sellers of goods will undoubtedly be affected by the states' reactions to this proposal; but few felt its application directly enough to organize any specific presentation or comment.

One would have also anticipated that a great many tax professionals would participate in this process on the assumption that their clients faced many and continuing problems with the states' various applications of P.L. 86-272. Again, with few exceptions, the tax professionals did not take full advantage of the opportunity to provide input into this process. Two organizations - the Financial Institution State Tax Coalition and the National Private Truck Council - did present their particular views on certain aspects of the Statement; and a few individual taxpayer and state representatives contributed to a broad discussion of the proposal.⁵

⁵ Interpretations of Public Law 86-272 are often two-edged. Due to the interplay between destination or market states and shipping states that may or may not have a throwback rule, most private tax professionals have clients balanced on the edge of this sword, so that support for one interpretation for one client may conflict with the interests of another. Therefore, to avoid this dilemma, the private tax professional could say very little. It is noteworthy that those private, as well as government tax professionals who were able to

B. Specific Issues Addressed

The Hearing Officer has recommended that several changes and additions be made to the Phase One Statement. All of these recommendations are set forth and made notable on Attachment 8, the mark-up version of the Statement. A majority, but not all of the recommended changes and additions are specifically discussed in this section. Those that are not discussed were considered by the Hearing Officer to be either (i) minor language changes for clarification purposes, or (ii) more substantive, but not requiring further explanation.

The Hearing Officer has specifically discussed recommendations on the following subjects:

- Issue 1: **Whether an "in-home" office is protected under the Public Law?**
- Issue 2: **Whether the in-state possession and use of certain business equipment should be protected activity?**
- Issue 3: **Whether the in-state delivery of goods in the seller's own trucks removes the protection under the Public Law?**
- Issue 4: **Whether the providing of shipment or delivery information or the coordination of deliveries into the state should be protected activity?**
- Issue 5: **Whether a state should adopt a *de minimis* level of gross receipts, property, payroll or other factors after applying the Public Law to determine whether to assert taxing jurisdiction?**
- Issue 6: **Whether the Statement should extend the protections under the Public Law to sellers of services and to those who perform services in connection with the sale of goods?**

submit constructive suggestions regarding specific language, will find many of their suggestions incorporated within the recommended Phase Two Statement. See Attachment 14.

- Issue 7: **Whether collection of a seller's accounts that are conducted through third parties removes the protection under the Public Law?**
- Issue 8: **Whether the law of the state of destination should apply for the purpose of settling conflicts regarding the operation of jurisdictional and throwback rules?**
- Issue 9: **Whether registration or qualification to do business in the state, by itself, should be a protected activity?**
- Issue 10: **Whether the conducting of activities that are unprotected under the Public Law during a part of the tax year removes the protection from sales generated and income earned prior to the conducting of the unprotected activities?**
- Issue 11: **Whether the states should apply the *Joyce Rule* or the *Finnigan/Airborne Navigation* approach for determining the extent of protection under the Public Law?**

Specific recommendations regarding the treatment of the eleven issues set forth above are provided as follows:

Issue 1:

The In-Home Office

Public Law 86-272 does not permit the out-of-state seller to maintain an office of its own of any kind within the market state. Only a true independent contractor can have an office in the market state from which the independent contractor may solicit customers and make sales on behalf of the out-of-state seller. As noted by one prominent Senator prior to passage of the Public Law,

"...We have now stricken out the provision with regard to an office. A business firm cannot even have an office to write orders. It is only when a traveling salesman goes in and sells goods subject to consummation at the home office that an exception is made. A sale is not consummated in the State. It is transferred in the State which originates the shipment."

105 Cong. Record 16489 (1959)(remarks of Senator Bird)..

This strict prohibition was underscored by the *Wrigley* Court's conclusion that the *de minimis* and ancillary concepts did not encompass the seller maintaining any kind of office in the state. See *Wrigley*, 112 S.Ct. 2447, 2457. The Hearing Officer recognizes, as do many state representatives, that salespersons will often use a portion of their residences to maintain records; to place and receive telephone calls; to write to customers; to communicate with the home office; and to do a variety of activities that might otherwise be protected under P.L. 86-272 or this Phase Two Statement. The issue then arises as to when does the use of a small portion of one's home in the conduct of otherwise protected activity cross a line between a convenient support for the conducting of protected activities and the maintenance of an "office" which is unprotected by the Public Law.

Is having one two-drawer file cabinet for keeping orders straight in a spare bedroom protected? Are two two-drawer file cabinets unprotected? What about one four-drawer file cabinet? What about one two-drawer file cabinet and a telephone used for only soliciting sales? What if the salesperson used a typewriter to communicate with customers? If that is protected, how about the use of a personal computer and a printer? When does equipment that is used for personal convenience by the salesperson become equipment that transforms a spare bedroom into an office? Or, should a salesperson who hands out his business card to prospective customers that states the company's name and a telephone number where the salesperson could be reached at an "in-home" office remove the immunity? What if a salesperson confirms receipt of an order by writing to the customer on stationery that reflects the company name and telephone number and address of the "in-home office"?

These questions and the scores more that arise from the in-home office issue require states and out-of-state sellers to do battle over a great variety of factual circumstances, diverting their resources from more productive business. On the one hand, the states could take the position that any use of an employee's personal residence for business purposes equates to the company maintaining an office in the state. On the other, the states can more clearly define the in-state activities they will permit without invoking the strict "office" prohibition under the Public Law. The Hearing Officer recommends the latter approach.

Prior to the passage of the Public Law, during hearings before the U.S. Senate's Finance Committee, Fred L. Cox, Conferee for the Georgia Department of Revenue and Chair of the Interstate Allocation of Business Income Committee of the National Tax Association, offered up the following definition of the term "office" that was included in one of the related bill drafts:

"The term 'office' shall include the residence of any officer, employee, agent or representative if such residence is identified in the trade with the business of such corporation.....". (Emphasis supplied).

State Taxation of Interstate Commerce: Hearings before the Committee on Finance of the United States Senate, 86th Cong., 1st Sess. 206, 221 (1959)(testimony of Fred L. Cox).

Because the term "office" does not appear in the final version of the Public Law, one can draw no inference as to whether such a limitation was contemplated by Congress. Mr. Cox's offering, however, can be viewed for what it appears to be - the position of the states at that time as to what type of in-home office should be permitted without loss of protection. Apparently, at that time, the states were willing to extend protection to an in-home office, so long as that office or the residence in which it was located was not publicly "identified in the trade" with the out-of-state seller.

Recommendation:

The Hearing Officer submits that certain in-state activity is more of convenience, than substantive, and constitutes less than a public demonstration of the company's in-state presence. States can spend their time and resources more prudently, without undermining the basic philosophy and limitations found in the Public Law, by permitting, without be required by the Public Law, a limited "in-home office" to be maintained by representatives of the out-of-state company. So long as the company, either through its employees or otherwise, (i) does not publicly hold itself out as having an office in the state or (ii) does not, in fact, maintain an office in the traditional sense (one not included within a residence), the major concerns about maintaining an in-state office will likely be met. Therefore, the following language is recommended to be included in the Statement at paragraph IV.A.18 under "Unprotected Activities":

18. Maintaining, by any employee or other representative, an office or place of business of any kind (other than an in-home office located within the residence of the employee or other representative that (i) is not publicly attributed to the company or to the employee or other representative of the company in an representative capacity, and (ii) so long as the use of such office is limited to soliciting and receiving orders from customers; for transmitting such orders outside the state for acceptance or rejection by the company; or for such other activities that are protected under either under Public Law 86-272 or under this Statement.

A telephone listing or other public listing within the state for the company or for an employee or other representative of the company in a representative capacity or other indication through advertising or business literature that the company or its employee or other representative can be contacted at a specific address within the state shall normally be determined as the company maintaining within this state an office or place of business attributable to the company or to its employee or other representative in their representative capacity. However, the normal distribution and use of business cards and stationery identifying the employee or representative's name, address, telephone and fax numbers and affiliation with the company shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the company or to its employee or other representative.

The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described above shall, by itself, cause the loss of protection under this Statement.

For the purpose of this subsection it is not relevant whether the company pays directly, indirectly, or not at all for the cost of maintaining such in-home office.

See corresponding changes made to IV.B.2 and 13.

Issue 2:

The In-state Use of Certain Business Equipment

A question arises when a salesperson uses certain type of equipment in the course of the in-state activities conducted on the seller's behalf as to whether Public Law 86-272 protection is lost. Equipment, such as typewriters, telephones (traditional, portable, or cellular), personal computers and the software to run them, copiers, facsimile machines and the like are modern day necessities if business activities are to be conducted efficiently. The *Wrigley* case made obvious what most states believed to be the correct approach to the in-state use by the salesperson of a company owned or leased automobile. The Court was not going to construe the Public Law in such a fashion that protected only those salespersons who took public transportation or walked to their customers' stores or factories.

One reasonable approach is for the states to anticipate what their courts are likely to permit as property that is ancillary to solicitation and to permit them specifically here. It will often be counter-productive for the states to make a lot of fuzzy distinctions between activities that are inconsequential, thereby increasing audit and compliance issues that will rarely be cost-effective. The question of what types of equipment may be used in the state without losing the immunity is an appropriate area of the states to permit some leeway. If an automobile is to be treated as ancillary to solicitation, should a cellular phone that is used solely to request orders not be similarly treated. Or a copying machine use to solicitations for orders or orders? Or a facsimile machine used to transmit orders to the home office for acceptance or reception? Or a personal computer on which to maintain programs that support the salesperson's ability to solicit customers? While these types of equipment can be used for purposes other than those protected under the Public Law, if their use is limited solely to protected activities, such use will likely be protected as ancillary to the activities protected by the Public Law.

Recommendation:

The Hearing Officer is convinced that some provision should be provided in the Statement that minimizes areas of possible contention and litigation. Where in-state activities - the use of certain specified equipment - are, in fact, limited solely to protected activities specified under the Public Law, the Statement should protect those limited activities, even though the equipment arguably could be used for activities that are not so protected. For example, if the salesperson uses the company-furnished automobile to drive to and from potential customers' stores for the purpose of soliciting sales, such activity and

the automobile would be protected under the Public Law. However, if the automobile were used to pick up and replace damaged or returned goods, or for selling samples to customers, such use would not be protected and, if conducted on a more than *de minimis* basis, would result in the removal of protection under the Public Law. If, therefore, the facsimile machine were used solely for protected activities, such as solicitation or the transmission of orders to the home office, the use of the equipment would be protected under this Statement, regardless of whether such use would be protected under the Public Law. However, should the equipment be used for unprotected activities, such as conducting credit checks, facilitating the return of damaged goods, for the sale of samples and the like, the protection would be lost.

Based upon the above discussion, the Hearing Officer recommends the addition of paragraph IV.B.13. to provide:

13. Owning, leasing, using or maintaining personal property for use in the employee or representative's "in-home" office or automobile that is solely limited to the conducting of protected activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer and computer software that is limited to the carrying on of protected solicitation and activity entirely ancillary to such solicitation or permitted by this Statement under paragraph IV.B. shall not, by itself, remove the protection under this Statement.

(See also paragraph IV.B.5. which protects the providing of automobiles to sales personnel "*for their use in conducting protected activities.*")

Issue 3:

Delivery of Goods in the Seller's Own Trucks

"P.L. 86-272 protects the solicitation of orders for the sale of tangible personal property when such orders are sent out-of-state for acceptance or rejection and filled *by shipment or delivery* from a point outside the State ...". (Emphasis added).

Testimony received on behalf of the National Private Truck Council, Inc. (NPTC), a trade association that represents companies that operate private truck fleets to make deliveries in furtherance of a non-transportation primary business, to the effect that Public Law 86-272 protection extends to private

motor carrier, as well as for-hire, deliveries. NPTC noted that at least three states (Massachusetts, Virginia and Delaware) and possibly a fourth (Pennsylvania) have recently taken the position that use of the seller's own trucks for delivery of its goods is beyond the protection of P.L. 86-272. Arguing that such a construction violates P.L. 86-272, NPTC urges the MTC to add language to the Statement "clearly and unequivocally" providing that shipment or] delivery of goods by private motor carriage is a protected activity under P.L. 86-272. See Attachment 9, p. 7.

The Public Law is susceptible of two interpretations in this regard - the one proposed by the NPTC that delivery in the seller's own trucks is protected activity; and the one relied upon by states, such as Massachusetts, that such activity is not protected. A review of the legislative history of P.L. 86-272 prior to its passage reveals little by way of clues whether Congress intended to limit the protection of the Public Law to only those sellers who transport their goods to the buyer by for-hire and common carriers, as opposed to private carriers. The closest references to this issue are found in the report of the hearings held by the Special Subcommittee on State Taxation of Interstate Commerce of the House of Representatives, Judiciary Committee, H.R. Rep. No. 1480, 88th Cong., 2nd Sess. (1964) (hereafter, the "Willis Committee Report"). The Willis Committee Report was issued five years after the passage of the Public Law and, therefore, is of limited value as a source of legislative history. There, the following was reported at p. 146 -

"The primary area of ambiguity in the statute revolves around the terms 'solicitation' and 'delivery' - the question of what kinds of activity may be considered an integral part of the process of solicitation and sale. It seems highly probable, at one extreme that the statute would be held to protect a company whose soliciting salesmen used company-owned automobiles in the performance of their duties. It also seems highly probable that soliciting salesmen may carry samples of their company's products. But it is much less clear whether a company is protected in a State if it rents a display room there, or has its salesmen investigate complaints of customers. Are these activities integral parts of the process of soliciting trade, or are they discrete activities not covered by Public Law 86-272? Similarly, although the statute makes it clear that delivery of goods into a State does not deprive the selling company of statutory immunity, there can be doubt about the meaning of delivery. Does the term "delivery", for example, include installation

work - a term broad enough to encompass both jobs requiring 5 minutes and those requiring 5 weeks? Has a company done more than deliver its products into a State if it retains a security interest in the goods sold? Is it deprived of the statutory protection if, in response to warranty obligations, it services the products sold on the customer's premises?⁶ These are some of the questions on which the guidance given by Public Law 86-272 is not wholly clear."

Unfortunately for our inquiry here, the Willis Committee Report does not directly and unambiguously discuss this issue. Through its discussion of the term "delivery", one might argue that the Report, while suggesting that the term is unclear, nevertheless assumed that delivery by any means, including private carrier, was protected. However, the discussion did not center around the means of delivery, but what activities - installation and retention of a security interest - occurred at or after delivery. In any event, the above-quoted passage, to this Hearing Officer's reading, did not reflect any clear understanding on the Subcommittee's part of whether the use of the seller's own delivery trucks removed the immunity otherwise present.⁷

NPTC also argues that Congress somehow incorporated within P.L. 86-272 a construction of "shipment or delivery" that includes private carrier delivery. It argues that prior to the adoption of the Public Law in 1959, the United States Supreme Court's decision in *Miller Bros. v. Maryland*, 347 U.S. 340 (1954) "specifically recognized that 'delivery' could be accomplished by private carriage and that P.L. 86-272 includes no language to the contrary". The Hearing Officer concludes that *Miller Bros.* teaches us very little on this subject. That case dealt with Due Process issues in the context of a duty to

⁶ The equivocal nature of the discussion of the warranty service issue overlooks the statement by Senator Javits *prior to* the passage of the Public Law in which he remarked:

"I point out that one of the major things which is not incorporated in this minimal standard is servicing and maintenance, which is a very essential element of operation in a particular State, and which calls upon the use of the State facilities in a way very different from the solicitation of orders."

105 Cong. Record 16377 (1959)(remarks of Senator Javits).

⁷ An additional reference is found at page 499 of the Willis Committee Report. There, in discussing the results of a survey responded to by businesses the following statement was made: "The employee activities which have been treated [for the purpose of survey response] by Public Law 86-272 are solicitation of orders without the authority to accept them, 'missionary' activity, and *delivery of goods in company-operated vehicles.*" (Emphasis added).

collect *transactional* taxes where one factor was the "occasional delivery of goods" in the seller's own trucks. *Id.* at 347. The span stretching between the facts and holding in *Miller Bros.* and the particular statutory construction urged here by NPTC is too great, without more, for this Hearing Officer to jump.

A more productive avenue for deciphering the meaning of the terms "shipment" and "delivery" would be to determine the common usage of such terms by the transportation industry prior to the passage of the Public Law. If such common usage reflects that the term "shipment" is limited to the placing of goods with a for-hire contract or common carrier for transportation to the buyer and the term "delivery" is limited to the transporting of a company's goods by its own trucks, our inquiry could reasonably end. However, no evidence of such common usage in the trucking trade was offered by NPTC; therefore, for these purposes, it is assumed that no such common usage exists.

The Hearing Officer must then decide whether Congress, by using the two different words, "shipment" and "delivery", intended two different meanings; and, if so, whether either word necessarily encompasses the use of the seller's own trucks or other mode of private carrier delivery. Under normal rules of statutory construction, a statute is to be construed, wherever possible, to give meaning and effect to every word and statutes are not to be construed to render certain words superfluous or insignificant. See, *Zeigler Coal Co. v. Kleppe*, 536 F.2d 398 (D.C. App. 1976) and *Besette v. Enderlin School Dist.*, 288 N.W.2d 67 (N.D. 1980). The Hearing Officer sees no justification for diverging from these standard rules of construction here.

Cases construing the terms "shipment" and "delivery" have normally concluded that the former is satisfied by placing goods in the hands of a common carrier for transportation to the buyer, while the latter is met by placing the goods in the actual or constructive possession of the buyer or the buyer's agent. See, *Pan American World Airways, Inc. v. Morgan*, 513 P.2d 278, 282 (Wash. 1973); and *Integrity Ins. Co. v. Marine Midland Bank-Western*, 90 Misc.2d 868, 396 N.Y.S.2d 319 (Sup. Ct. 1977). See also, *Goosic Const. Co. v. City Nat. Bank of Crete*, 196 Neb. 86, 241 N.W.2d 521, 522 (1975). In *Satco, Inc., v. Board of Equalization*, 144 C.A.3d 12, 192 Cal. Rptr. 449, (1983), the court held the term "delivery" to be a term of art meaning the point at which ownership is transferred from the seller to the buyer. Under normal shipment contracts, the seller is merely obligated to place the goods in the hands of a carrier for title and risk of loss to pass to the buyer; while a delivery or destination contract normally obligates actual delivery to the buyer or buyer's agent before title passes. See *Chemlease Worldwide Inc. v. Brace, Inc.*, 338 N.W.2d 428 (Minn. 1983); see also U.C.C. § 2-401. Thus, unless otherwise agreed to, delivery ordinarily occurs either (i) when the goods are placed in the

hands of a common carrier under a shipment type of contract or (ii) when physical possession is actually delivered to the buyer or its agent under a destination or delivery type of contract.

Based upon the foregoing, whether "shipment" is called for or "delivery" is called for may well depend upon the terms of the sales contract and intent of the parties. What is fairly certain is that each of the terms has a different meaning when used as a term of the sale. But, our inquiry does not end here, as neither term necessarily includes or excludes the concept of delivery in the seller's own trucks or by other private carriers.

Another source of direction may be found in the Uniform Division of Income for Tax Purposes Act (UDITPA). UDITPA was drafted by the National Commission on Uniform State Laws in 1957 and was clearly before the Congressional committees dealing with the Public Law. See S. Rep. No. 453, pp.10-11, 86th Cong., 1st Sess. (1959). When addressing the assignment of sales to the receipts factor numerator for division of income purposes, Section 16 of UDITPA provides that -

"[s]ales of tangible personal property are in this State if:

(a) the property is shipped or delivered to a purchaser...within this State *regardless of the f.o.b. point or other conditions of the sale*; or

(b) the property is shipped from [a location] in this State... and the taxpayer is not taxable in the State of the purchaser." (Emphasis supplied).

In the context of UDITPA, the terms "shipment" and "delivery" appear to have taken on slightly different meanings than have developed in the sales or U.C.C. context. Under UDITPA, the seller has "shipped" its goods for sales factor sourcing purposes by merely transferring the goods to a common or for hire carrier, irrespective of the use of either a shipment or a delivery type of contract. The UDITPA states treat the sale as sourced to the destination state when common carriers are used, even though the shipping documents may reflect a shipment contract.

The term "delivery" under Section 16 has often been construed by the UDITPA states (for "dock sales" purposes) as meaning the transferring of actual possession to the buyer, ordinarily by the loading of the purchased goods onto the buyer's truck or rail car (or one under the control of the buyer) at the seller's dock. Thus, under many circumstances, the construction of both terms under Section 16 of UDITPA - "shipment" and "delivery" - allow for different

meanings between the terms themselves; but some of those meanings do not necessarily include the use of the seller's own truck or rail car for transporting the goods into the market state.

Thus, meaning may be given to both terms found in the federal legislation, as is required by general rules of statutory construction, but neither would necessarily support the arguments and conclusions advanced by NPTC. It remains possible that Congress intended the same meanings to be attributed to the terms "shipment" and "delivery" as contemplated under UDITPA. Therefore, a seller can ship by common carrier and a seller can deliver to a buyer at the seller's dock, with actual or constructive possession being transferred in each case "from a point outside of the [taxing] State" If this is what was meant by Congress, then the delivery of goods by the seller's own trucks into the taxing state would not have been intended to be protected under the Public Law.

As noted above, at least three states have recently decided not to construe either term of the Public Law as encompassing a seller's right to deliver its goods via its own trucks and remain protected. The State of New York, however, had earlier decided that the test of whether shipment or delivery is protected depends upon the actual point of origin being outside the state, and not the type or ownership of carrier used. See, New York State Tax Commission Advisory Opinion, TSB-A-84(11)C dated September 14, 1984 (Attachment 10). See also, the recent amendments to New York Business Corporation Franchise Tax Regulations Section 1-3.2(a)(3) which interpret P.L. 86-272 and made no changes to the Department's Advisory Opinion TSB-A-84(11)C in this regard.

Recommendation

Because the NPTC is currently seeking judicial resolution of this issue, what the Hearing Officer concludes here will be unlikely to address this issue in any lasting, meaningful way. The Hearing Officer has concluded, for the purposes of this Statement, to be guided by the direction of the Supreme Court's opinions directing that preemption of state taxation by a federal statute, such as P.L. 86-272, be limited to those circumstances in which it is the "clear and manifest purpose of Congress". See *Department of Revenue of Oregon v. ACF Industries, Inc., et al.*, ___ U. S. ___ (slip op., pp. 11-12) (1994), *Cipollone v. Liggett Group, Inc.*, 505 U.S. ___, 112 S.Ct. 2608, 120 L.Ed.2d 407, 422 (1992), *Heublein, Inc. v. South Carolina Tax Com.*, 409 U.S. 275, 281-282 (1972).

Based upon the foregoing, the Hearing Officer recommends that, until this issue is judicially decided, states treat shipments and deliveries of goods by means of private carrier as unprotected activity, irrespective of whether a separate fee is charged to the purchaser. The following provision is recommended for this approach:

IV.A. Unprotected Activities:

20. Shipping or delivering goods into this state by means of private vehicle, rail, water, air or other private carrier, irrespective of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser.

Should any state determine, however, not to follow the Hearing Officer's recommendation and wish to treat delivery of goods in other than a common carrier as a protected activity, so long as a delivery fee is not charged to the purchaser, the following language is recommended :

IV.A. Unprotected Activities:

20. Shipping or delivering goods into this state by means of private vehicle, rail, water, air or other private carrier for which a shipment or delivery fee is imposed, directly or indirectly, upon the purchaser.

Should any state determine, however, not to follow the Hearing Officer's recommendation and wish to treat delivery of goods in other than a common carrier as a protected activity, irrespective of whether a delivery fee is charged to the purchaser, the following language is recommended :

IV.B. Protected Activities:

14. Shipping or delivering goods to a purchaser in this state from a point outside this state by any means of transportation, including private carrier, irrespective of whether a delivery fee is charged.

Because the Hearing Officer has recommended that the states treat as unprotected those deliveries and shipments made in private carriers, the last two suggested provisions will not appear in Attachment 7 as a final recommendation. They are offered here only for the purpose of achieving an

additional measure of uniformity of language should any state(s) wish to depart from the recommended provision.

Issue 4:

Providing Shipment or Delivery Information or Coordinating Deliveries

This issue was not addressed during the public proceedings. However, the Hearing Officer concludes that a court would likely hold that a salesperson, who advises a potential customer during the solicitation process of the expected timetable for shipment of the order, would not be exceeding the Public Law limits regarding solicitation. Part of the solicitation "pitch" would logically include informing the customer of the time frame within which the goods would be made available to the customer. Even though the states could likely "hold the line" at limiting the providing such information during the solicitation, is there good reason to do so? Or, should the company representatives be allowed to provide such information after the point of solicitation without risking removal of the protection which was earlier afforded to the transaction itself?

Recommendation:

The Hearing Officer recommends that the providing of shipping and delivery information both prior and subsequent to the sale should be afforded protection. One could argue that doing so after the order is placed becomes a protected ancillary activity of the seller's shipment and delivery duties. The appropriate type of shipment and delivery of the goods, so long as commenced from outside the market state, constitute protected activities under the Public Law. Additionally, the difficulty in detecting and enforcing a limitation on passing along such information is substantial and creates more traps for the unwary than provides a matter of sound tax administration.

The coordination of deliveries or shipments of the customer's goods falls within the same line of reasoning as noted above with regard to providing the information regarding the shipments and deliveries. The Hearing Officer concludes that protection should be afforded these activities, as well, irrespective of whether or not a court might ultimately rule such was required by the Public Law. To this extent, it is suggested that original paragraph II.A.13. appearing in the Phase One Statement be deleted and the following language be included at IV.B.8. of the Phase Two Statement:

8. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order.

Issue 5:

De Minimis Level of Gross Receipts, Property, Payroll, or Other Factors

In rejecting Wisconsin's argument that the Public Law does not allow for *de minimis* exceptions, the *Wrigley* Court noted that -

"[Wisconsin's argument] ignores the fact that the venerable maxim *de minimis non curat lex* ("the law cares not for trifles") is part of the established background of legal principles against which all enactments are adopted, and which all enactments (absent contrary indication) are deemed to accept....[citations omitted].... . It would be especially unreasonable to abandon normal application of the *de minimis* principle in construing §381, which operates in such stark, all-or-nothing fashion: A company either has complete net income tax immunity or it has none at all, even for its solicitation activities."

Wrigley, 112 U.S. 2457-8.

Would the states be required under the Public Law to afford protection to out-of-state companies that conduct substantial and unprotected activities in the state, but which have such minimal sales that the net income to be apportioned to the market state was trivial or *de minimis*? This issue is discussed below, but the Hearing Officer makes no conclusion as to it based upon the current state of the law.

It is a fact that no state tax administrator has at his or her command sufficient resources to require all who are required under state law to register and file tax returns to do so. Tax administrators do all they can to educate those required to file returns and to enforce their state tax laws as fully and even-handed as their resources permit. But reality requires tax administrators to ration their resources and prioritize their compliance efforts. Few, if any, states have sufficient resources to search out all non-filers whose activities conducted and income earned within their states are minimal.

Should a tax administrator be required to spend a \$1.00 of state funds to collect \$.50 in tax that may be owed the state? Or to spend \$1,000,000 on a certain compliance program that he or she can reasonably anticipate will achieve far less than \$1,000,000 of tax revenue? One valid tax administration rationale for trying to require even those out-of-state companies that earn very little, if any income in the market state, and even those who suffer losses is that when the company has a "good year", some positive tax revenue may result. On the flip side is that too often the tax administrator is compelled to chase "good money after bad", with no net revenue resulting from a compliance program with a very low jurisdictional nexus standard, because doing so provides credibility to other enforcement programs.

From the perspective of the business taxpayer, how frustrating is it to be required to file a tax return in another state, when it costs more in accounting fees and other costs of compliance to file the return than the total tax that is due? Those that do business in an interstate environment, where minimal income (or loss) is at issue, continually face the issue of whether or not to incur filing burdens and comply with the tax laws of other states. Asserting the belief that common sense dictates their action, many businesses will avoid registration in states in which their activities create minimal tax consequences. Should the states apply a *de minimis* level of income or activity - even beyond that protected by the Public Law - to ensure that government and private resources not be diverted from more productive activity? Is it good state tax policy, as well as in the public's best interest, for government to ensure that small businesses are not burdened by compliance duties where there is negligible, if any, tax revenue at issue?

The Hearing Officer notes that there has not as yet been a United States Supreme Court case in the income apportionment area under either the Due Process or Commerce Clauses of the United States Constitution that prohibits states from imposing a net income or franchise tax measured by net income on any amount of income derived from interstate activities, no matter how small, so long as the four-prong test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) is satisfied.⁸ If the activities in the taxing state exceed those protected under Public Law 86-272, the business has little legal basis upon which to complain that it is required to comply with the state's general tax laws. But should our inquiry end there? Or, should the states now conduct a more in-depth review, from a joint perspective, of when it is appropriate to

⁸ Those four prongs require that the tax (1) be applied to an activity with a substantial nexus to the taxing state; (2) be fairly apportioned; (3) not discriminatory against interstate commerce; and (4) fairly related to the services provided by the state.

place upon interstate business activities the cumulative burdens of multijurisdictional tax compliance?

In *Quill Corp. v. North Dakota*, 112 U.S. 1904 (1992), the United States Supreme Court re-affirmed its long-standing concern regarding the cumulative burdens that are placed upon interstate commerce in the use tax collection context. Of course, this concern was based upon the Court's belief that if it were to allow state and local jurisdictions to require use tax collection on mail order sales, over 6,000 jurisdictions with a myriad of tax exemptions, would be pursuing the vendor for their taxes, and on a monthly filing basis as well. In the context of state corporate franchise and income taxes, however, the number of state and local jurisdictions seeking to apply their income or franchise tax laws to interstate sellers at present is quite small. For now, the burden placed on interstate commerce in the income and franchise tax area, from a registration and filing perspective, should not be considered undue under Commerce Clause standards. But, is there is a growing number of local jurisdictions seeking to impose taxes measured by net income on interstate businesses? If so, the same concerns expressed by the Court in *Quill* - the cumulative burdensome effect of having to comply with a myriad of state and local jurisdictions' tax laws - may come into play in some future case.⁹

It is important to note here that thirty years ago Congress first expressed its concern with the cost-benefit ratio of the states' imposing their income taxes in a manner that produced "small-liability returns". In 1964, the Willis Committee reported as follows:

"It is also inevitable that the State income tax system should introduce additional tendencies to produce returns showing small tax liabilities. State income tax rates are very much lower than the Federal rates. Moreover, for companies paying income taxes in more than one State, the tax of each State is generally imposed on only a portion of the company-wide net income. But if these two factors make a high proportion of small-liability returns at the State level inevitable, they also have another significance. In combination, they will tend to produce some small-liability returns that cannot be justified as essential to sound administration of the

⁹ It may be argued that since Congress has already set forth its *de minimis* activities requirements in Public Law 86-272 that no additional activities or minimum level of receipts are required under the Commerce Clause with respect to income and franchise taxes measured by net income. Irrespective of this fairly sound legal position, it remains in the state and local jurisdictions' best interest in preserving their tax systems to appear before the Supreme Court with well considered compliance approaches.

revenue laws. In the absence of a jurisdictional limitation, a small company filing large numbers of State income tax returns may find itself making periodic reports to tax collectors in States in which it could never realistically hope to have significant tax liability.

One objective of a jurisdictional rule, then, should be to relieve companies from income tax obligations in cases in which their activities in a State are so minimal that they are unlikely ever to be producers of significant amounts of tax."

Willis Committee Report, p. 488 (emphasis added).

The Supreme Court recently denied review of the case of *Geoffrey Inc. v. South Carolina Tax Commission*, No. 23886 (S.C. July 6, 1993)(slip op.), cert. denied, 62 U.S.L.W. 3375 (11/29/93). In the *Geoffrey* case, South Carolina successfully imposed its franchise tax on earnings derived from license fees earned in South Carolina over an out-of-state corporation that had no physical presence within South Carolina. This issue, left open by the Court in *Quill*, applies to activities and taxes that are not now protected under the Public Law, e.g., business activities relating to the sale and delivery of services and income earned from intangibles. Tax Administrators of both state and local governments may feel more "bullish" than "bearish" in now asserting corporate income tax jurisdiction in these areas. Therefore, now may be an opportune time for state Tax Administrators to consider the wisdom of establishing de minimis activity or gross receipts levels before committing to compliance measures that are either not cost effective or that risk violation of Commerce Clause restrictions.¹⁰

¹⁰ It is noteworthy that prior to the adoption of S.2524 (later to become P.L. 86-272) that Senator Long proposed an amendment (later rejected) that would have removed the application of the Public Law where, during the taxable year, the business had sales in the state in excess of the lesser of \$1,000,000 or "an amount determined by multiplying the population of such State (according to the last decennial census) by 50 cents." See also, Lee Sheppard, "Geoffrey: The Commerce Clause in the Information Age", State Tax Notes (January 3, 1994), p. 35 wherein the author, in discussing *Quill* and *Geoffrey*, states at p. 36:

"....Systematic exploitation of a state's markets ought to be enough for substantial nexus. If need be, to avoid undue administrative burdens for small merchants, the word 'substantial' could be administratively modified to require a specific dollar volume of business with the state's residents before responsibility for tax would attach."

Recommendation:

The Hearing Officer recommends that the Executive Committee authorize the Uniformity Committee to review the appropriateness and feasibility of establishing "*de minimis*" gross receipts or apportionment factor standards for inclusion in the Phase Two Statement at some future date. Such review should consider various alternatives, including an approach similar to that proposed by the bills seeking to congressionally limit the *National Bellas Hess* case. That approach imposes a use tax collection obligation only when sales during a 1-year period ending as a certain date of the previous calendar year exceeds a minimum level. (See also footnote 10 for another type of "gross receipts" *de minimis* approach that was originally suggested regarding Public Law 86-272).

For still another approach, the Hearing Officer recommends consideration by the Uniformity Committee of the following provision:

De Minimis Level of Gross Receipts, Federal Taxable Income and In-State Apportionment Factor.

Any corporation subject to the personal jurisdiction of this State that is not otherwise protected under Public Law 86-272 or Section IV.B. from being required to pay a corporate income (franchise) tax to this State shall not be required to file a corporate income (franchise) tax return or pay such a tax for any taxable year unless, during such taxable year, the corporation either--

(1) had gross receipts from interstate transactions--

(A) within the United states exceeding \$_____, or

(B) within the State exceeding \$_____; or

(2) had a federal taxable income prior to state adjustments exceeding \$_____ and an apportionment factor attributable to this State exceeding ____%.

See Attachment 11 for support by California Franchise Tax Board for this type of suggestion.

Issue 6:

Extending Protection under the Public Law to the Sale and Delivery of Services

Submissions received from the Financial Institutions State Tax (FIST) Coalition urge the Commission to treat all industries on a "uniform basis", arguing that "parity in taxation treats all taxpayers equally and does not discriminate against one industry based on a product or service line." On behalf of FIST, Fred Ferguson requests that the Commission -

"...adopt and recommend to its member states, that for the purposes of parity, service companies should be treated similarly to sellers of tangible personal property under P.L. 86-272. The FIST Coalition would be willing to work with the MTC to achieve this end." See Attachment 12.

It is clear that the protection of the Public Law has been limited by Congress to the sale of tangible personal property. The House of Representatives' version of the legislation did not limit the protection to sales of tangible personal property, and sought it to apply to "any business engaged in interstate commerce...". See, H.R. Rep. No. 936, 86th Cong., 1st Sess. 2 (1959). But, the bill as finally passed was the Senate's version (S. 2424), which limited the protection to those engaged in the sale of tangible personal property. As noted in the Willis Committee Report at p. 146:

"[Public Law 86-272] does not apply to activities connected with the sale of services. In such cases, the question of tax liability still turns on the applications of those general constitutional principles which the judicial branch has developed in the absence of congressional action. Moreover, as applied to many factual situations, Public Law 86-272 is itself unclear."

On a purely theoretical level relating to possible economic distortions that may occur in investment decisions caused by differential tax treatment, the Hearing Officer sees some merit in FIST's view that for at least for the purpose of jurisdictional nexus, sellers of services should be treated similarly to sellers of tangible personal property. From the market states' perspective both types of sellers draw, though varying in degree, upon public resources. Both compete with local businesses for a share of sales to the states' residents; and they both rely heavily upon a stable, educated marketplace within the state.

The Hearing Officer supports the general principle that state tax systems should not distort investment choices and, to that extent, shares FIST's goal of achieving tax parity wherever it makes sense to do so. The Hearing Officer departs company with Mr. Ferguson and FIST on how to achieve that goal, as they would carve out yet another huge area of interstate commerce for protection from taxation under vague guidelines. The Hearing Officer believes that one solution lies in the repeal of Public Law 86-272, coupled with voluntary state action in establishing clear and quantifiable *de minimis* standards as to when an out-of-state business need file returns. Such standards (an example of which is suggested above with reference to Issue 6) would provide more clarity than the vagaries contained in Public Law 86-272; would identify readily those states in which an interstate seller must file returns; and would protect smaller interstate businesses from having to comply with state tax laws when to do so would not be revenue productive.

The law is clear that a sale or delivery of a service is not a protected activity under Public Law 86-272. With regard to the sale or delivery of a service that is in some manner associated with the sale of the tangible personal property, the Hearing Officer concludes that the immunity under the Public Law is also not available to such transactions, unless the service is either ancillary to the original solicitation of the order or otherwise permitted by the signatory states under the Statement. Thus, where the seller of goods also provides such services as installation, warranty repair, and maintenance with respect to the goods sold, whether separately compensated for or not, such activities remove the immunity that otherwise might have been provided under the Public Law.

There are occasions when it may be more difficult to determine whether a service is being provided in the state or not. For example, if printed materials, such as a magazine, are sold and delivered into a market state, do the advertisements that appear in the magazine suggest that a service is being provided to the advertiser? If so, then the sale of the tangible personal property would also consist of the delivery of a service - the distribution by the publisher of the advertisers' messages - to the marketplace. As such, the immunity under the Public Law should not apply to protect the publisher from market state attribution of the receipts from either the magazine sales or the receipts for the advertising services.

For another example, assume that an out-of-state computer software manufacturer solicits the sale of software that it will design specifically for the in-state buyer (not "canned", "off the shelf" software) and delivers the software package from a point outside the state the market state. Here, even though the computer disks are tangible personal property, most states would treat the

receipts as being derived from services provided by the development of the individualized software. As such, the software manufacturer would not be protected under the Public Law.

A further example is found when a seller of goods also delivers those goods in its own trucks. There, while a protected solicitation of tangible personal property may have occurred earlier, the seller has engaged in a separate transaction in the market state - the providing of delivery services. At least where the seller has imposed a charge for private carriage delivery services, the Public Law's "delivery or shipment" protection may not apply. This is because the seller would not be solely engaged in the solicitation of sales of tangible personal property in the state, but could be viewed as providing a business in the state as well. Thus, certain activities conducted by the seller remove the protection under the Public Law, unless all methods of shipment and delivery - by common carrier or by the seller's own trucks - were protected. See the discussion of Issue 3. above.

Recommendation:

In order to provide notice to the business community of the issue regarding the delivery of services, either connected or not with the solicitation and delivery of tangible personal property, the Hearing Officer suggests the following language be added to Section I of the Statement:

The sale or delivery and the solicitation for the sale or delivery of any type of service that is not either (i) ancillary to solicitation or (ii) otherwise set forth as a protected activity under the Section IV.B. hereof is not protected under Public Law 86-272 or this Statement.

With regard to the more theoretical issue raised by FIST - the achieving of parity of treatment between sellers of goods and sellers of services - the Hearing Officer concludes few states, if any, will voluntarily rush to raise jurisdictional barriers to their taxation of interstate sellers of services. For the Hearing Officer to suggest here that the states raise such barriers would border on the frivolous and may well undermine the credibility of the remaining recommendations contained in this Final Report.¹¹

¹¹ The Hearing Officer does not wish to imply that FIST's suggestion is frivolous when viewed from its own perspective and is thankful for the opportunity address it. However, the Hearing Officer declines to make any recommendation that does not stand a "snow ball's chance" of being widely accepted by State Tax Administrators. Recommending that the states further limit their right to assert taxing jurisdiction over service businesses contributing over

The states should continue to protect their right to impose their taxes to the fullest extent permissible under state and federal Constitutions; however, it remains in the best interest of the states to impose their jurisdictional reach in a thoughtful and practical manner. It is one thing for a state to have the right to impose its tax obligations on out-of-state companies, it is another when that imposition can be viewed as an unreasonable and undue burdening of interstate commerce. The states are now working in a post-*Wrigley* environment - one in which state courts and the United States Supreme Court will be interested in construing Public Law 86-272 and fleshing out the definitions of such broad and judgmental concepts as "ancillary", "trivial" and "*de minimis*". Therefore, the Hearing Officer repeats here his recommendation that the states voluntarily review the feasibility of developing a *de minimis* standard in the nature as that suggested in the recommendation to Issue 5 above. By this approach - the taking of a proactive step to create a *de minimis* standard - the states would be better able to demonstrate to taxpayers, the courts and Congress the wisdom and clarity of their tax administration practices.

Issue 7:

Account Collection through Third Parties

Should the fact that an out-of-state seller assigns its accounts receivable for collection by a collection agency or other third party, instead of the seller collecting the accounts directly, be a protected activity? The Hearing Officer concludes that an indirect method of collecting one's debts through assignment (presumably for some immediate or contingent value) should not be a protected activity where the direct method of account collection is not. The Statement should make clear that if the out-of-state seller wishes to have its customers pay their debts through activities that extend beyond those protected by the Public Law, e.g., collection activities with or without the use of in-state courts, the seller has exceeded the protection afforded by the Public Law.

one-half the GDP of the United States will only result in the State Tax Administrators making comments about the Hearing Officer, such as, "I told you so, he's crazy, simply crazy"; or "Remember the old saying - 'He who chases red herrings ends up smelling like dead fish'".

Recommendation:

Paragraph IV.A.2. should be changed to provide as follows:

Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.

Issue 8:

Application of Law of the Destination State

The vast majority of income tax states have adopted the Uniform Division of Income for Tax Purposes Act (UDITPA) three-factor apportionment formula of property, payroll and sales. Many of the states have retained UDITPA's equally-weighted factor approach; however, several states have in recent years have double-weighted their sales factor. In any event, the sales factor is the only market-oriented factor in either the single-weighted or double-weighted formulas. Thus, since the payroll and property factors are production-state factors, the formula begins with a bias toward the production state. In order to maintain any modicum of market influence in the formula, the receipts factor should be protected whenever options are presented that may shift the formula balance even more greatly toward the production state side.

One method of retaining the current level of market state influence to the three-factor formula is to maintain a strong destination-based sales factor. Each state has adopted policies that theoretically take into account its mixture of market and production state elements. The taxing philosophy of each state is reflected, in part, through its nexus or jurisdictional approaches and whether it has adopted a throwback rule to throw back those receipts which are not taken into a market state's apportionment formula. If a state wishes to protect its tax position as a market state it will more aggressively apply a lower jurisdictional standard to activities occurring within its borders. If it wishes to take in the receipts of its resident companies that ship to market states that for some reason do not or cannot include such receipts in their factors, it will use a throwback approach. If it does not want to saddle outbound sales with a contribution to its taxation, the home state will give up on any throwback, even though those sales cannot be assigned to the market state.

The Hearing Officer concludes that the policies of the market or destination states should be looked to initially to determine whether a given receipt should be included in its receipts factor numerator. Such has been the case with UDITPA and the Statement should build on that principle in order to

protect the market state factor. Therefore, where there is a conflict between a throwback state and a market or destination state as to which state a given receipt should be assigned, the Hearing Office recommends that the Statement include a process that will likely reconcile that conflict. That process is one of consultation between the interested states with the destination state's laws being the initial starting place. It must be emphasized here that no state is required to forego any right it has under its own laws, but is required only to confer, in good faith, with the other interested state in an attempt to avoid a conflict that results in double-counting of receipts. This consultation, with its beginning preference point being the law of the destination state, should also lead to more uniform understanding and application of the Statement.

Recommendation:

Based upon the foregoing, the Hearing Officer recommends the addition of a new Article VI. to provide as follows:

**VI.
APPLICATION OF DESTINATION STATE LAW
IN CASE OF CONFLICT**

When it appears that two or more signatory states have included or will include the same receipts from a sale in their respective sales factor numerators, at the written request of the company, said states will in good faith confer with one another to determine which state should be assigned said receipts. Such conference shall identify what law, regulation or written guideline, if any, has been adopted in the state of destination with respect to the issue. The state of destination shall be that location at which the purchaser or its designee actually receives the property, regardless of f.o.b. point or other conditions of sale.

In determining which state is to receive the assignment of the receipts at issue, preference shall be given to any clearly applicable law, regulation or written guideline that has been adopted in state of destination. However, except in the case of the definition of what constitutes "tangible personal property", this state is not required by this Statement to

follow any other state's law, regulation or written guideline should this state determine that to do so (i) would conflict with its own laws, regulations, or written guidelines and (ii) would not clearly reflect the income-producing activity of the company within this state.

Notwithstanding any provision set forth in this Statement to the contrary, as between this state and any other signatory state, this state agrees to apply the definition of "tangible personal property" that exists in the state of destination to determine the application of P.L. 86-272 and issues of throwback, if any. Should the state of destination not have any applicable definition of such term so that it could be reasonably determined whether the property at issue constitutes "tangible personal property", then each signatory state may treat such property in any manner that would clearly reflect the income-producing activity of the company within said state.

Issue 9:

Registration or Qualification to Do Business in the State

An issue frequently raised is whether an out-of-state company's registering or formally qualifying to do business in the market state removes the immunity otherwise available to its in-state solicitation activities. The most recent state court decision on this issue has held that the mere qualifying to do business does not, without more, remove the immunity under Public Law 86-272. See, *Kelly Springfield Tire Company, et al. v. Bajorski*, 228 Conn. 137, ___ A.2d. ___, 1993 Conn. Lexis 410 (slip op. December 21, 1993). In *Kelly Springfield*, the Connecticut Supreme Court reasoned that, as a matter of statutory construction, since the Public Law permitted imposition of tax on a corporation incorporated under the laws of the taxing state, "it would make no sense to ascribe the same significance to the act of qualifying to do business."¹²

¹² The *Kelly Springfield* Court overlooked at least one similar state protection afforded in many states to both corporations that are incorporated in the state, as well as to foreign corporations registered to do business there. That is, states protect the use of the business and trade names of both in-state and out-of-state corporations registered to do business there. Such name protection is an important benefit provided to the out-of-state company that one could argue places both types of corporations on similar footing regarding the receipt of state benefits and protections.

Recommendation:

In the interest of achieving as much uniformity as possible without protracted litigation having to settle the issue in each state, the Hearing Officer recommends that a state treat the mere registration to do business therein by an out-of-state company as not removing the immunity otherwise available under the Public Law. However, should the out-of-state company seek to use or protect other benefits and protections in the state, such as trade or corporate name protection, then a state could reasonably take the position that the immunity is lost, since such action on behalf of the company would be beyond mere registration or qualification to do business. To this end, the Hearing Officer recommends that paragraph VII.C. be added to the Statement to provide:

C. Registration or Qualification to Do Business

A company that registers or otherwise formally qualifies to do business within this state does not, by that fact alone, lose its protection under P.L. 86-272. Where, separate from or ancillary to such registration or qualification, the company receives and seeks to use or protect any additional benefit or protection from this state through activity not otherwise protected under P.L. 86-272 or this Statement, such protection shall be removed.

Issue 10:

Part of Tax Year to which Immunity Attaches

One of the issues raised during the public hearing process related to the extent to which the immunity is lost if, during the tax period, the out-of-state seller conducted activities beyond the protection of the Public Law. Assume, for this purpose, that an out-of-state company sells its goods into Your State; that it is on a calendar fiscal year filing basis; and that during the period from

It is interesting to note that under this construction of the Public Law, a corporation that is incorporated in a market state that only has independent contractors selling there and no other in-state contacts will be subject to the state's taxation. However, an out-of-state corporation that has its own employees residing and selling in the state may not be so subjected to the state's taxation.

January through November of 1993 it has limited its in-state activities solely to those protected under the Public Law. Then, during December, the company conducts some activities in Your State that are in excess of those protected under the Public Law. Are all of the company's sales that are made in Your State through November protected sales under the Public Law? Or, are they all properly sourced to Your State and to be included in the sales factor numerator for Your State? Or, are only those December sales that are made during the period in which the unprotected activities were conducted to be included in the sales factor?

Section (a) of Public Law 86-272 provides that the grant of immunity from market state taxation is for the income of a company "for any taxable year if the only business activities ..[conducted in the market state].. during such taxable year" are protected activities. The Hearing Officer concludes that the entire immunity is lost by the out-of-state company for any taxable year in which it conducts activities in excess of the protection of the Public Law. Therefore, in the example provided, the company would be required to source all of its 1993 sales to Your State. This conclusion is supported by S. Rep. No. 658, 86th Cong., 1st Sess. (1959) at p. 2553 where the Senate Finance Committee reported as follows with respect to S. 2524:

"The immunity provided by subsection (a) of section 1 of the bill will not be available to a person, however, if the business activities by salesmen within the State on behalf of such person are not limited during the taxable year to the solicitation of such orders ..." (Emphasis added).

Recommendation:

The Hearing Officer recommends that the following language be added as paragraph VII.D. of the Statement to clarify that no immunity attaches to any extent during any tax year in which any unprotected activity was conducted:

D. Part of Tax Year to which Immunity Attaches.

The protection afforded under P.L. 86-272 and the provisions of this Statement shall be determined on a tax year by tax year basis. Therefore, if at any time during a tax year the company conducts activities that are not protected under P.L. 86-272 or this Statement, no sales in this state or income earned by the company attributed to this state during any part of said tax year shall be protected from taxation under said Public Law or this Statement.

Issue 11:

The Joyce Rule or the Finnigan/Airborne Navigation Approach.

From 1966 until 1990, the California State Tax Board of Equalization held the position that even though certain corporate members of a combinable unitary group were taxable in California, the California-destined sales made by an out-of-state member of that unitary group would not be included in the California sales factor numerator if the out-of-state seller was otherwise protected by P.L. 86-272. See *Appeal of Joyce, Inc.*, Cal. St. Bd. of Equal. (11/23/66). In the *Joyce* case, the Board had viewed the sales of each member of the group separately, including in California's sales factor numerator only those sales by the entity over which it had jurisdiction.

In 1987, in the case of *Airborne Navigation Corporation v. Arizona Department of Revenue*, Dkt. No. 395-85-1, the Arizona State Board of Tax Appeals concluded that corporate members of a unitary business group should be considered as one "person" under the language of P.L. 86-272. Based on that conclusion, it further held that the sales into Arizona made by an out-of-state parent that was otherwise protected in Arizona under P.L. 86-272 would be included in the Arizona sales numerator of its combinable subsidiary over which Arizona otherwise had tax jurisdiction.

One obvious result of the interplay between the *Joyce* rule and the *Airborne Navigation* decision was apparently for both California (via operation of the throwback rule) and Arizona to include the parent's Arizona sales in both states' numerators.¹³ In 1990, the California Board of Equalization overruled its *Joyce* rule that it had held since at least 1966 when it decided the *Appeal of Finnigan Corporation*, Cal. St. Bd. of Equal., Opinion on Pet. for Rehg. (1/24/90). *Finnigan* was a circumstance in which one member of a unitary group that was located in California had shipped goods from California into Arizona where it was protected from taxation by P.L. 86-272. However, the seller's parent, another member of the unitary group, was taxable in Arizona. The Board, in reversing *Joyce*, held that the Arizona sales made by the California subsidiary were not to be thrown back to California because one of the corporations that was included in the unitary group (its parent) was taxable in Arizona. In entering its decision, the Board emphasized that it was only changing an *apportionment rule* and not altering any *rule of jurisdiction*.

¹³. It has been understood that the FTB has avoided this potential for double inclusion by acceding to Arizona's inclusion of the sales in its numerator.

On June 8, 1990, in response to the *Finnigan* decision, the Franchise Tax Board issued FTB Notice 90-3 changing its multi-entity apportionment formula rules to follow the Board of Equalization's ruling in *Finnigan*. It is apparent that the FTB also construes the *Finnigan* decision as a *rule of apportionment* and not a *rule of jurisdiction*. However, since the throwback rule language of Section 16 of UDITPA was the language being construed by the Board in *Finnigan* - whether the state to which the goods have been shipped had "jurisdiction to subject the taxpayer to a net income tax" - others argue that the answer to that question is at least partially wrapped in jurisdictional cloth, if not swaddled completely in it.¹⁴ One court has held that -

.... [a] formula that rests apportionment on the determination that the multistate taxpayer is a unitary business - a business whose activity outside the taxing state so functionally integrates with its activity within the taxing state as to make impossible the separate measurement of each to the multistate enterprise - satisfies the constitutional requirements of nexus and of a tax fairly related to the services provided by the taxing state. *ASARCO*, 458 U.S. at 316-317....".

Dow Chemical Company v. Director of Revenue, 787 S.W.2d 276, 280 (MO 1990).

In a recent trial court order entered in the California case of *Brown Group Retail v. Franchise Tax Board*, Los Angeles Sup. Ct. No. C714010, currently on appeal, the trial court held that *Joyce*, not *Finnigan* was the appropriate method for determining attribution of sales made by a member of a unitary group. The Commission's 1986 Guideline regarding P.L. 86-272 does not address this issue. When the Commission states developed the 1986 Guideline, they patterned most of the Guideline after a draft that was prepared by the California Franchise Tax Board staff; but the member states departed from the California draft by not specifically adopting the *Joyce* or any other rule regarding the effect of activities conducted in the state by unitary,

¹⁴. One commentator has suggested that taxing jurisdiction over one member of a multi-corporate unitary business would constitute taxing jurisdiction over the entire corporate group's income and factors. See, Eugene F. Corrigan, "Finnigan's Wake or Joyce's? The Application of the Unitary Principle to Combined Groups", *The Journal of California Taxation*, p. 5,6 (Fall 1989). See also, *Comptroller of the Treasury v. Armco Export Sales Corp.*, 572 A.2d 562 (Ct. of Spec. App. MD 1990) holding that nexus over DISC is established through unitary relationship with parent.

combinable corporations. The development of this Phase Two Statement provides an appropriate opportunity to revisit this issue and to determine which, if any, approach - *Joyce* or *Finnigan* and *Airborne Navigation* - should be recommended.¹⁵

A few hypothetical situations may be helpful here in order to appreciate what fact patterns may lead to over-inclusion or under-inclusion of sales in states' sales factor numerators. Assume for all of the hypotheticals that Corporation P. is a manufacturing and sales corporation located in State A. (the selling state) and that P.'s sales force scrupulously avoids any sales activities in State B. (the destination state) that would be unprotected by P.L. 86-272. Assume further that P.'s unitary and combinable subsidiary, Corporation S., is also located in State A. and makes sales into State B., but for some reason Corporation S.'s salespersons continually conduct activities in State B. that are not protected by P.L. 86-272. The following scenarios point up the potential problems for both states and taxpayers in applying *Joyce* and *Finnigan/Airborne Navigation* approaches.

Hypothetical #1

Where both the selling state (State A.) and the destination state (State B.) are separate entity states and State A. applies a throwback rule, sales otherwise protected by P.L. 86-272 that are made into State B. by P. Corporation would be thrown back and assigned to the numerator of State A. Any sales made from State A. into State B. by S. Corporation through activities that were not protected under P.L. 86-272 would be assigned to State B.'s numerator. ***Thus, neither corporation's sales would be double-counted in or excluded from the sales factors.***

Hypothetical #2

If both the selling state (State A.) and the destination state (State B.) are combination states that follow the *Joyce* decision (the activity of each member of the unitary group is to be separately measured against P.L. 86-272) and State A. applies a throwback rule, then sales otherwise protected by P.L. 86-272 that are made into State B. by P. Corporation would be thrown back and

¹⁵ See Ruurd Leegstra and Fred Marcus, "Joyce Overturned - Justice Denied?", *Journal of California Taxation* (Summer 1990) in which the authors conclude that the states cannot ignore the jurisdictional limitations set for in P.L. 86-272 through application of an apportionment approach such as that represented by *Finnigan*.

assigned to the numerator of State A. Any sales made from State A. into State B. by S. Corporation through activities that were not protected under P.L. 86-272 would be assigned to State B.'s numerator. ***Thus, neither corporation's sales would be double-counted or excluded from all factors.***

Hypothetical #3

If both the selling state (State A.) and the destination state (State B.) were combination states that followed the *Finnigan/Airborne Navigation* decisions (the activities of all members of the unitary group are to be jointly measured against P.L. 86-272) and State A. applied a throwback rule, the sales made into State B. by P. Corporation that were otherwise protected under P.L. 86-272 would not be thrown back to State A., since S. Corporation had conducted unprotected activities in State B. and would be assigned to the numerator of State B.. Any sales made by S. Corporation into State B. that were not protected by P.L. 86-272 would be assigned to State B.'s numerator. ***Thus, neither corporation's sales would be double-counted in or excluded from the sales factors.***

Hypothetical #4

If the selling state (State A.) is a separate entity state and the destination state (State B.) is a combination state that followed the *Joyce* decision and State A. applied a throwback rule, State A. would throw back and include in its sales numerator P. Corporation's sales made into State B. that were otherwise protected under P.L. 86-272 and not throw back the sales made into State B. by S. Corporation, whose sales were not protected under P.L. 86-272. State B. would exclude from its numerator the sales of P. Corporation, but would include the sales of S. Corporation, whose activities exceeded P.L. 86-272 protection. ***Thus, neither corporation's sales would be double-counted in or excluded from the sales factors.***

Hypothetical #5

If the selling state (State A.) was a combination state that followed the *Joyce* decision and applied the throwback rule, and the destination state (State B.) was a separate entity state, State A. would throw back and include in its sales numerator P. Corporation's sales made into State B. and not throw back the sales made into State B. by S. Corporation, whose activities exceeded P.L. 86-272 protection. State B. would exclude from its numerator the sales of the protected P. Corporation, but would include the sales of S. Corporation, whose activities exceeded P.L. 86-272 protection. ***Thus, neither corporation's sales would be double-counted in or excluded from the sales factors.***

Hypothetical #6

If the selling state (State A.) was a combination state that followed the *Joyce* decision and the destination state (State B.) was a combination state that followed the *Finnigan/Airborne Navigation* decisions and State A. applied a throwback rule, State A. would throw back and include in its numerator the sales of P. Corporation as they were protected under P.L. 86-272, but would not throw back the sales of S. Corporation, whose activities in State B. exceeded P.L. 86-272. But here, State B. would include in its sales numerator the sales made into State B. by both P. Corporation and S. Corporation. ***Thus, there would be a doubling of inclusion in the sales factor numerators of P. Corporation's sales.***

Hypothetical #7

If the selling state (State A.) was a combination state that followed the *Finnigan/Airborne Navigation* decisions and the destination state (State B.) was a combination state that followed the *Joyce* decision and State A. applied a throwback rule, State A. would not throw back the sales made by either the protected P. Corporation or its unprotected S. Corporation. But State B. would exclude from its numerator the sales of the P. Corporation and include the sales of S. Corporation, whose activities in State B. were not protected by P.L. 86-272. ***Thus, there would be an exclusion from both states' numerators of P. Corporation's sales.***

Hypothetical #8

If the selling state (State A.) was a separate entity state and the destination state (State B.) was a combination state that followed the *Finnigan/Airborne Navigation* decisions and State A. applied a throwback rule, State A. would throw back and include in its sales numerator the sales made into State B. by P. Corporation and would not throw back the sales made into State B. by S. Corporation, whose activities exceeded P.L. 86-272. But, State B. would include in its numerator the sales of both P. Corporation and S. Corporation. ***Thus, there would be a doubling of inclusion in the sales factor numerators of P. Corporation's sales.***

Hypothetical #9

If the selling state (State A.) was a combination state that followed the *Finnigan/Airborne Navigation* decisions and applied the throwback rule, and the destination state (State B.) was a separate entity state, State A. would not throw back and include in its sales numerator either the sales made into State B. by P. Corporation or by S. Corporation. But, State B. would exclude from its numerator the sales of P. Corporation and would include the sales of the unprotected S. Corporation. ***Thus, there would be an exclusion from both states' sales factor numerators of P. Corporation's sales.***

Based upon the issues raised in the above set of hypotheticals, it is a fair assumption that the same sales may be included twice or not at all in the states' numerators if the destination and selling states are mismatched according to whether one state is a *Joyce* state and the other is a *Finnigan* state or whether one state is a separate entity state and the other is a *Finnigan* follower. The match-ups work, with neither under-inclusion, nor over-inclusion of sales in the factors, in the following shipment state-to-destination state scenarios: separate entity state to separate entity state; *Joyce* state to *Joyce* state; *Finnigan* state to *Finnigan* state; separate entity state to *Joyce* state; and *Joyce* state to separate entity state.

This issue is in its judicial infancy, with but a handful of states having adopted the *Finnigan/Airborne Navigation* approach and pressed the issue. Based upon the Hearing Officer's experience, most unitary combination states still follow the *Joyce* rule. While the representatives of several states have expressed support for the theoretical underpinning for the *Finnigan/Airborne Navigation* approach, few state representatives believe they should change from a *Joyce* approach to a *Finnigan/Airborne Navigation* approach absent additional judicial support for the latter approach being developed throughout the states. That judicial support has not yet been developed.

Recommendation:

Until the *Finnigan/Airborne Navigation* approach is judicially affirmed in those states that have adopted it, such as California and Kansas, the Hearing Officer recommends that the states adhere to the "*Joyce Rule*". This recommendation is based more on pragmatism, than on any belief that the *Joyce Rule* is any better reasoned than the *Finnigan/Airborne Navigation* approach. It is merely too early to determine whether the *Finnigan/Airborne Navigation* approach will be judicially approved in any state other than Arizona. Until then, the Hearing Officer believes that the safer route to take is that upon which the majority of states have long ago embarked - the *Joyce Rule*.

The Hearing Officer recommends that the following language be added as paragraph VII.E. of the Statement to clarify that the recommendation that the states apply the principle established in *Appeal of Joyce, Inc.*, Cal. St. Bd. of Equal. (11/23/66) to determine whether sales are to be attributed to the destination state and, if not, to the shipping state on a throwback basis.

E. APPLICATION OF THE JOYCE RULE.

In determining whether the activities of any company have been conducted within this state beyond the protection of P.L. 86-272 or paragraph IV.B. of this Statement, the principle established in *Appeal of Joyce, Inc.*, Cal. St. Bd. of Equal. (11/23/66), commonly known as the "Joyce Rule", shall apply. Therefore, only those in-state activities that are conducted by or on behalf of said company shall be considered for this purpose. Activities that are conducted by any other person or business entity, whether or not said person or business entity is affiliated with said company, shall not be considered attributable to said company, unless such other person or business entity was acting in a representative capacity on behalf of said company.

**IV.
CONCLUSION**

The Hearing Officer trusts that the adoption of this Statement will lay to rest many of the issues and controversies that provide little in the way of determining sound tax policies. While several questions remain to be addressed in this area of state taxation of interstate business activities, most of the current issues that have been raised have been addressed with recommendations by the Hearing Officer.

Many of the remaining and continuing issues center around qualitative judgments as to what is "ancillary" to solicitation and what is "*de minimis*". These issues remain fact driven and will be the source of friction and litigation in the future. Such is the nature of the beast. Until Public Law 86-272 is replaced with an activities test that is subject to more exact measure, the pushes and pulls between the states and business community will remain with us. These too will eventually pass, as the sound intentions and good will of both State Tax Administrators and tax professionals will find a way to clarify, address and resolve many of the remaining issues.

This Final Report of Hearing Officer is respectfully submitted to the Multistate Tax Commission's Executive Committee on this 21st day of March, 1994.

A handwritten signature in cursive script, reading "Alan H. Friedman", is written over a horizontal line.

Alan H. Friedman
Hearing Officer

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